

**STATE OF ILLINOIS**  
**ILLINOIS COMMERCE COMMISSION**

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<b>Commonwealth Edison Company</b>	:	
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<b>Tariffs and charges submitted</b>	:	<b>Docket No. 11-0721</b>
<b>pursuant to Section 16-108.5 of the</b>	:	
<b>Public Utilities Act.</b>	:	

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**REPLY BRIEF OF THE STAFF**  
**OF THE ILLINOIS COMMERCE COMMISSION**

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**REPLY BRIEF OF THE STAFF  
OF THE ILLINOIS COMMERCE COMMISSION**

Staff of the Illinois Commerce Commission (“Staff”), by and through its counsel, pursuant to the direction of the Administrative Law Judges (“ALJs”) and Section 200.800 of the Illinois Administrative Code, respectfully submits its Reply Brief in the above-captioned matter.

**I. INTRODUCTION / STATEMENT OF THE CASE**

In addition to Staff and Commonwealth Edison Company (“ComEd” or “Company”), the following parties submitted Initial Briefs (“IBs”) in this matter: the People of the State of Illinois (“AG”) and AARP, the Citizens Utility Board (“CUB”) and the City of Chicago (“City”), Northeast Illinois Regional Commuter Railroad Corporation d/b/a/ Metra (“Metra”) and the Chicago Transit Authority (“CTA”), Illinois Industrial Energy Consumers (“IIEC”), the Commercial Group (“CG”), United States Department of Energy (“DOE”), and IBEW.

Aside from issues addressed in this Reply Brief, Staff stands by the positions articulated in Staff's IB. Failure to address a specific issue in this Reply Brief does not constitute a change of position from Staff's IB.

**II. OVERALL REVENUE REQUIREMENT**

**III. RATE BASE**

**A. Overview**

**B. Potentially Uncontested Issues**

**1. Plant-in-Service**

**a. 2010 Distribution Plant**

**b. 2010 General and Intangible Plant, Other Than  
Functionalization (see III.C.2.b)**

**2. Accumulated Deferred Income Taxes**

**a. SERP (see also V.b.8)**

**b. 401(k) Matching**

**3. Materials & Supplies Inventories**

**4. Regulatory Assets & Liabilities**

**a. Regulatory Assets**

**b. Asset Retirement Obligation**

**c. Deferred Credits**

**d. Other Deferred Charges**

**5. Customer Deposits, Including Staff Proposal Re Interest (see  
also V.B.2)**

**6. Customer Advances**

**7. Accumulated Depreciation & Amortization (Other than Derivative  
Impacts)**

**8. Non-AFUDC Construction Work in Progress**

**C. Potentially Contested Issues**

**1. Average Year or End of Year Rate Base (see also VIII.C.1)**

As discussed in more detail in section VIII.C.1 below, Staff affirms its recommendation that the Commission should adopt the Intervenor and Staff proposals to use average rate base to calculate what the revenue requirement would have been if the actual cost information for the applicable calendar year had been available at the filing date in the annual reconciliation as provided for in subsections 16-108.5(c)(6) and 16-108.5(d)(1) of the Public Utilities Act (“Act”). Average rate base is more representative of the actual plant balances in service throughout the year and more closely matches actual costs incurred during the year (e.g., depreciation expense) to the actual plant in service during the year. Further, an average rate base more closely matches actual capital investment in plant and associated return requirements during the year to the other expenses being incurred during the year. (Staff IB, pp. 7-8)

## **2. Plant-in-Service**

### **a. Original Cost Finding 2010 Plant**

Staff affirms its recommendation that the Commission should unconditionally approve \$14,398,674,000 as the Original Cost of Plant in Service as of December 31, 2010, as presented on Staff Ex. 16.0, Sch. 16.05, which includes the impact on original cost of Staff’s adjustments proposed in this proceeding. (Staff IB, p. 8) Should the Commission make any additional adjustments to plant, those additional adjustments should also be considered in the original cost determination. Further, Staff recommends that the Commission include the following language in the Findings and Orderings paragraphs of its Order in this proceeding:

(#) The Commission, based on ComEd’s proposed original cost of plant in service as of December 31, 2010, before adjustments, of \$14,426,332,000, and reflecting the

Commission's determination adjusting that figure, unconditionally approves \$14,398,674,000 as the composite original cost of jurisdictional distribution services plant in service as of December 31, 2010.

**b. 2010 General and Intangible Plant Functionalization**

Staff affirms its recommendation that the Commission should adopt Staff witness Bridal's adjustment to reduce the overall balance of distribution-related general and intangible ("G&I") plant and corresponding depreciation expense and accumulated depreciation amounts as a result of changes to the allocation of specific G&I plant accounts proposed by Staff witness Rukosuev, discussed below. (Staff IB, pp. 8-9)

**i. Methodologies**

ComEd's defense of its proposed functionalization of G&I plant fails to appropriately address Staff's criticisms. Therefore, Staff recommends that the Commission reject the Company's proposal and reaffirm the existing functional allocation methodology it has approved in previous proceedings.

ComEd advocates changing the established procedures that were used to allocate G&I plant between the FERC transmission and ICC delivery service jurisdictions in prior Illinois rate cases, purportedly to better align jurisdictional allocation practices with FERC ratemaking policies. (ComEd IB, p. 28) ComEd supports its proposed allocation by arguing that it is consistent with the methods it uses for the Formula Transmission Rate, which means that, over time, ComEd will neither over- nor under-recover these costs under its transmission and distribution rates. (*Id.*) However, this consistency argument does not provide a sufficient basis to accept the Company's revised allocation methodology. In fact, ComEd has remained structurally unchanged; that is, the nature of its underlying plant assets and how they are used has not changed

since Docket No. 10-0467, so it is difficult to rationalize why such changes are warranted at this time. (AG/AARP Ex-1.0, p.42)

There is a clear incentive for ComEd to use functional allocators that would allow it to benefit financially. Specifically, ComEd's revenue requirement would increase by approximately \$2,171 million, if its proposal is approved. (Staff IB, p. 14) ComEd has made methodological changes that increase the functionalization of G&I Plant costs to the distribution function and reduced it as to the transmission function without demonstrating that its proposed jurisdictional allocation of G&I Plant costs between its transmission and delivery services customers is reasonable. It is still essential for the Company to demonstrate that its proposed approach is just and reasonable for ratemaking according to Commission standards. (*Id.*, pp. 11-12)

Not only did ComEd fail to make this demonstration, but Staff, AG, and CUB presented compelling arguments calling into question ComEd's proposed allocation methodology. (Staff IB, pp. 8-14; AG IB, pp.12-13; CUB IB, pp. 17-19) In assigning costs to the regulated transmission and distribution functions of the utility, ComEd has, without adequate explanation, proposed to change the method for functionalizing G&I plant which has been approved by the Commission for ComEd not only in Docket No 10-0467, but also in Docket Nos. 05-0597, 07-0566 and 08-0532. (Order, Docket No. 10-0467, May 24, 2011, p. 40) While the Commission is not a judicial body and its orders do not have the effect of *res judicata* (*Mississippi River Fuel Corp. v. Illinois Commerce Comm'n*, 1 Ill. 2d 509, 513, (1953)) if the Commission drastically departs from past practices, its decisions are entitled to less deference. *Citizens Utility Board v.*

*Illinois Commerce Comm'n*, 166 Ill.2d 111 (1995) (*Lakehead Pipeline Co. Ltd., v. Illinois Commerce Comm'n*, 296 Ill.3d 942, 956 (1998).

Thus, it is incumbent on ComEd to demonstrate why the method that was previously approved is now no longer appropriate for ComEd. However, ComEd provides an unpersuasive reason for changing the G&I plant allocation methodology that results in significantly increased revenue requirements for its delivery service customers if adopted. Instead, ComEd focuses on what the utility contends other parties have not done. (ComEd IB, p. 31) ComEd incorrectly claims that “[n]ot only did ComEd’s direct case provide supporting documentation of its position on the alignment issue, but ComEd provided further documentation in discovery and in surrebuttal.” (*Id.*, p. 31) Despite these claims, the evidence in the case fails to demonstrate that ComEd’s modified G&I plant allocation approach featuring a subjective wages and salaries (“W&S”) allocator is cost-based, and justifies a change in the Commission’s past determination about this issue, most recently in Docket No. 10-0467.

Moreover, Staff rejects ComEd’s results-driven argument that states “[t]he downward direction of the Staff / AG/AARP / CUB adjustment is driven by the differences in Accounts 390 and 394.” (ComEd IB, p. 29) The main criteria for selecting a method for allocating G&I plant costs should be cost drivers, not results. The fact that the impacts of Staff’s proposed changes to ComEd’s allocation methods produce the highest impact to Accounts 390-394 does not establish a fallacy in Staff’s approach, and it certainly does not provide a basis to adopt ComEd’s questionable approach to allocate these costs which would increase ComEd’s distribution revenue requirement by approximately \$2,171,000 (Staff IB, p. 14)

In sum, the Commission must ensure the proper cost allocation between ComEd's transmission service customers and its delivery services customers. The Act clearly places the burden of proof upon ComEd to establish that the costs it proposes to recover are just and reasonable. (See 220 ILCS 5/9-201) The burden of demonstrating which of ComEd's costs should be allocated to its delivery and supply customers lies with ComEd. (*Id.*) Throughout the course of this proceeding, Staff and Interveners properly rejected ComEd's proposed theories under which significant portions of its G&I Plant would be allocated to its delivery services customers.

Furthermore, ComEd argues that Staff witness Rukosuev's G&I plant functionalization methodology proposal is contrary to both state and federal law. (ComEd IB, p. 31) Regarding state law, ComEd argues that it has a right under the Act to the opportunity to fully recover its cost of delivery services which is defined under the Act to include both transmission services and distribution services. (*Id.*, p. 32) Regarding federal law, ComEd argues that Staff's methodology violates the filed rate doctrine. (*Id.*) The Commission should not let the Company hide behind these legal arguments to avoid facing the flaws in its proposed allocation methodology. These legal arguments should be rejected for the reasons set forth below. The Commission should evaluate the issue on the merits and come to the same conclusion as it did less than a year ago in Docket No. 10-0467 and reject the Company's W&S allocation proposal.

ComEd's argument ignores established law that costs, besides pertaining to operations or delivery services, must also be reasonable and prudent. (*Commonwealth Edison Co. v. Illinois Commerce Comm'n*, 398 Ill.App3d 510, 516 (2009)) As Staff set

forth in its IB, ComEd's proposed methodology is less accurate than the current methodology which was approved in ComEd's last rate case, Docket No. 10-0467 partially because ComEd's proposed W&S methodology uses more general allocators and less direct assignment of costs than the current methodology. (Staff IB, p. 12) As Staff witness Rukosuev testified: (1) the functionalization of the costs should be based on the allocation method approved by the Commission in Docket No. 10-0467; and (2) the methodology that ComEd proposes is not just and reasonable. (Staff Ex. 21.0, p. 11) While it is not clear if ComEd is suggesting in its state law argument that Staff is not allowing ComEd to charge its customers the transmission rate established at FERC, that is simply not the case. Staff witness Rukosuev was very clear on the scope of his testimony. ("Just to be clear, I am not recommending any change to the Company's FERC tariffs. My focus is on the delivery service tariffs." (Staff Ex. 21.0, p. 6)) Based upon the above, the Commission should reject ComEd's state law argument.

The Commission should also reject ComEd's federal filed rate doctrine argument since the doctrine does not apply to the facts in this proceeding. As the Commission set forth in Docket No. 05-0160, "[t]he federal 'filed rate' doctrine is a rule of preemption that requires state utility commissions to give binding effect to wholesale rates filed with or approved by FERC." (See *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 962 (1986); *General Motors Corp. v. Illinois Commerce Comm'n*, 143 Ill. 2d 407, 416-417 (1991), cert denied 504 U.S. 908 (1992), 112 S.Ct. 1936 (1992)) Under the filed rate doctrine, states are required to give effect to determinations made by FERC. Thus, state utility commissions may not question or alter a FERC-approved wholesale rate or deny recovery of FERC-mandated costs that the utility cannot avoid." (Order, Docket

Nos. 05-0160, 05-0161 and 05-0162 (Cons.), January 24, 2006, p. 34) As Staff just pointed out in this brief, Mr. Rukosuev was very clear in his testimony that he was "... not recommending any change to the Company's FERC tariffs. [His] focus [was] on the delivery service tariffs." (Staff Ex. 21.0, p. 6) Staff is not proposing to disallow any FERC-approved rate. In addition, Mr. Rukosuev's position that the Company's allocation methodology produces unjust and unreasonable allocation of costs to delivery service customers is consistent with the Illinois Supreme Court decision in *United Cities Gas Co.* addressing the filed rate doctrine. In *United Cities*, the court held that the filed rate doctrine did not require the Commission to allow a utility to charge its customers for costs exceeding those which are properly and prudently allocable to them. ("The filed rate doctrine does not require the Commission to allow United Cities to charge Illinois customers for costs exceeding those which are properly and prudently allocable to them." *United Cities Gas Co. v. Illinois Commerce Comm'n*, 163 Ill. 2d 1, 27 (1994)") Based upon the above, the Commission should reject the Company's filed rate doctrine argument.

**ii. W&S Allocator Calculation (see also V.C.1.e)**

Staff and the Company continue to disagree on the calculation of the Wages and Salaries Allocator (W&S Allocator). Specifically, ComEd has arbitrarily excluded \$1,432,396 of production wages and salaries from the denominator of the W&S Allocator. Staff's comprehensive recommendation is that the denominator of the W&S Allocator should reflect all wages and salaries paid by ComEd.

ComEd has failed to cite any theoretical, legal, or practical arguments to justify the exclusion of production wages and salaries from the calculation of the W&S

Allocator. Instead, ComEd attempts to confuse the issue by ignoring the plain language of the law and misinterprets Staff's position. Beginning on page 68 of its IB, ComEd states that "(b)ecause ComEd is a transmission and distribution company, ComEd's proposed W&S Allocator appropriately allocates these common costs between transmission and distribution functions consistent with the *ComEd 2010 Order*." (ComEd IB, p. 68) ComEd conveniently ignores important and relevant facts in that statement. First, ComEd reported \$1,432,396 in wages and salaries classified not as transmission or distribution wages and salaries, but as "Production" wages and salaries in its 2010 FERC 1 Annual Report.<sup>1</sup> The implication is that it would be inappropriate for the Commission to consider Production Wages in the computation of the W&S Allocator since, in the words of ComEd, the Company is a "transmission and distribution" company. The acceptance of ComEd's proposal would require a complete disregard of the facts.

To ignore or exclude production wages allows ComEd to miscalculate the W&S Allocator and shifts additional supply cost (i.e., production) to the distribution customers. Again, ComEd has not provided any theoretical, legal or practical justification for excluding production wages from the denominator of the W&S Allocator.

The second fact ignored by ComEd is the plain requirement of Section 16.108.5(c) of the Act which states, in part:

A participating utility may elect to recover its delivery services costs through a performance-based formula rate approved by the Commission.  
(220 ILCS 5/16-108.5 (c))

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<sup>1</sup> ComEd, FERC Financial Report FERC Form 1, Annual Report of Major Electric Utilities, Licensees and Others, p. 354, Column (B) Line 3.

The law does not provide for a recovery of non-delivery service costs. The plain language of the statute is that a participating utility is only allowed to recover its delivery service costs.

ComEd also makes the subtle inference that if the Commission accepts Staff witness Knepler's comprehensive W&S Allocator, then ComEd will be denied recovery of non-delivery service costs, or at least "in this docket." (ComEd IB, p. 68) ComEd has the option of seeking recovery of non-delivery service costs under a more appropriate mechanism. The purpose of this proceeding is not to make ComEd whole by over-charging delivery service customers for non-delivery service costs. The goal of the Commission in this proceeding to approve rates that "[p]rovide for the recovery of the utility's actual costs of delivery services that are prudently incurred and reasonable in amount consistent with Commission practice and law." (220 ILCS 5/16-108.5(c)(1)) (emphasis added)

Elsewhere, ComEd repeats its "*de minimis*" argument made previously in testimony and in its IB. (ComEd IB, p. 69) According to ComEd, the W&S Allocator adjustment involves just a "handful of ComEd employees (roughly one-half of one percent)", and thus, given the minor amount involved, it would be appropriate for the Commission to ignore this adjustment and devote its attention to more material matters. (ComEd IB, p. 68) ComEd further concludes that the only logical course of action is for the Commission to approve rates that over-charge delivery service customers by \$2.7 million annually. Staff has previously addressed this argument in testimony and in its IB and it will not be repeated in this reply brief. ComEd's "*de minimis*" argument is not based upon sound regulatory policy, nor is it supported by fact or law and therefore

should be rejected outright by the Commission. (ComEd Ex 14.0, p. 20, 444-446; ComEd IB, p. 68-69; Staff Ex. 14.0, p. 5; Staff IB, p. 16)

Lastly, ComEd takes a position that is contradictory to the testimony of two of its own witnesses by suggesting that the Commission should address supply related issues in this proceeding. (ComEd IB, p. 70) ComEd states that if its wage and salary allocator is denied, then the Commission should approve a supply cost recovery through Rider PE of the \$2.7 million adjustment. (*Id.*) Such a position by ComEd is contrary to ComEd witnesses Dr. Hemphill and Mr. Fruehe who both testified that supply charges are not an issue in this proceeding. (ComEd Ex. 11.0, p. 31, 651-654; ComEd Ex. 13.0, p. 39, 829-831). Staff witness Knepler has also acknowledged that supply charges recovered through Rider PE are not an issue in this proceeding. (Staff Ex. 14.0, p. 6) Accordingly, ComEd's request for Rider PE recovery of allocated overhead costs is beyond the scope of this proceeding and should not be considered by the Commission in this proceeding.

**c. 2011 Plant Additions**

Staff affirms its recommendation that the Commission adopt Staff's adjustments to remove certain projects from the Company's projection of 2011 plant additions, and to reduce the Company's aggregate forecast of 2011 plant additions. (Staff IB, pp. 18-25; p. 6, fn. 2)

With respect to 2011 plant additions, Staff witness Rashid contends that, consistent with Sections 9-211 and 9-212 of the Act, any distribution capital project that ComEd has cancelled or has not completed by the end of 2011 is not used and useful; therefore, the Commission should not include that project in rate base. Mr. Rashid

further contends that the Commission should not include in rate base any distribution capital project that is not part of ComEd's 2011 forecasted plant because Section 16-108.5(d)(1) of the Act reads, in pertinent part:

The inputs to the performance-based formula rate for the applicable rate year shall be based on final historical data reflected in the utility's most recently filed annual FERC Form 1 plus projected plant additions and correspondingly updated depreciation reserve and expense for the calendar year in which the inputs are filed. (220 ILCS 5/16-108.5(d)(1))

ComEd filed its formula rate inputs in 2011. Therefore, Section 16-108.5(d)(1) allows only projected plant additions for the year 2011 to be considered.

ComEd criticized Mr. Rashid's analysis and labeled it a "one-sided, and project specific test, [that] is not supported by or reflected in any language of Section 16-108.5(c) or (d)." (ComEd IB, p. 35) Staff rejects ComEd's contention. Mr. Rashid's analysis is consistent with Section 16-108.5(c). Mr. Rashid reviewed specific distribution projects identified in ComEd's testimony, Schedule F-4 and data request responses. (Staff Ex. 8.0, pp. 4-6) That review is consistent with the requirements of Section 285.6100 of the Illinois Administrative Code (Schedule F-4: Additions to Plant in Service Since the Last Rate Case), which requires utilities to "[provide] information concerning plant additions included in rate base on Schedule B-1 that are not currently in the rate base ordered in the utility's most recent rate proceeding." (83 Ill. Adm. Code 285.6100) Section 285.6100 requires a utility to provide information on the most costly plant additions. Mr. Rashid examined not only the most costly plant additions on which ComEd provided information, but also examined other projects. (Staff Ex. 8.0, p. 2) Mr. Rashid conducted his review of those projects for purposes of determining whether the

projects were prudent and used and useful. (Staff Ex. 8.0, pp. 3-4) ComEd ignores the plain language of Section 16-108.5(c) which provides that:

After the utility files its proposed performance-based formula rate structure and protocols and initial rates, the Commission shall initiate a docket to review the filing. The Commission shall enter an order approving, or approving as modified, the performance-based formula rate, including the initial rates, as just and reasonable within 270 days after the date on which the tariff was filed, or, if the tariff is filed within 14 days after the effective date of this amendatory Act of the 97th General Assembly, then by May 31, 2012. Such review shall be based on the same evidentiary standards, including, but not limited to, those concerning the prudence and reasonableness of the costs incurred by the utility, the Commission applies in a hearing to review a filing for a general increase in rates under Article IX of this Act. The initial rates shall take effect within 30 days after the Commission's order approving the performance-based formula rate tariff.  
(220 ILCS 5/16-108.5(c) (emphasis added))

By examining ComEd's projected plant additions set forth on Schedule F-4 and additional projects, Mr. Rashid is conducting a review of ComEd's filing using the same evidentiary standards that apply in a filing for a general increase in rates by examining the prudence and reasonableness of the filing, which is clearly required under Section 16-108.5(c).

In its IB, ComEd focuses on its overall forecasted plant additions compared to its alleged actual 2011 plant additions. (ComEd IB, p. 33) The Commission should reject ComEd's contention that "what is ultimately at issue here is ComEd's overall projection of plant additions for 2011." (ComEd Ex. 26.0, p. 3) ComEd's assertion that the Commission should allow it to recover the cost of distribution capital projects that it included in rate base based on the "overall plant additions" (ComEd Ex. 17.0 Corrected, p. 3-4), regardless of whether ComEd originally included these projects in its 2011 projection for plant additions, is not supported by Sections 9-211, 9-212, or 16-108.5 of

the Act. In fact, ComEd's decision to implement new projects that it did not originally include in its 2011 forecasted plant additions and include their cost in rate base appears to be an attempt to effectively nullify the meaningfulness of the Commission's review of forecasted plant additions.

If the Commission determines ComEd's rate base as the Act requires and as Staff recommends, which it should, all of ComEd's new prudent and used and useful capital projects will eventually go into rate base, even if they do not appear in ComEd's 2011 projections. Section 16-108.5 of the Act uses both projections and actual investments to calculate rate base, and a used and useful ComEd capital project will eventually show up as a completed project.

Section 16-108.5(d)(1) of the Act states, in part:

The filing shall also include a reconciliation of the revenue requirement that was in effect for the prior rate year (as set by the cost inputs for the prior rate year) with the actual revenue requirement for the prior rate year (as reflected in the applicable FERC Form 1 that reports the actual costs for the prior rate year).  
(220 ILCS 5/16-108.5(d)(1))

Every year, ComEd will file inputs to the performance-based formula rate based upon ComEd's projections for the filing year in addition to actual data from the most recently filed FERC Form-1. (220 ILCS 5/16-108.5(d)) In the tariffs that ComEd will file in May 2012, a reconciliation of actual capital plant additions will presumably take place. ComEd acknowledges this fact in its witness' testimony. (ComEd Ex. 17.0 Corrected, p 3) Therefore, it is inappropriate and premature to consider including variations from ComEd 2011 capital plant additions forecast in the instant proceeding.

Finally, ComEd argues that disregarding ComEd's actual data showing actual plant additions exceeding ComEd's projections would be arbitrary and contrary to the

law. (ComEd IB, p. 34) ComEd cites to *Business and Professional People for the Public Interest v. Illinois Commerce Comm'n*, 146 Ill. 2d 175, 236 (1991) to support its argument. It is beyond comprehension how the Commission, by following the requirements of Section 16-108.5(d)(1), would somehow be acting arbitrarily. Accordingly, the Commission should reject this argument by ComEd.

For these reasons, the Commission should accept Mr. Rashid's recommendation to disallow \$14,926,065 from inclusion in ComEd's proposed rate base.

Contrary to assertions in the Company's IB (ComEd IB, pp. 34-35), Staff's adjustments to 2011 projected plant additions are calculated correctly as set forth in Staff Ex. 16.01R, taking into account all necessary revisions and updates. (Staff IB, p. 6, fn. 2) Staff's analysis of the aggregate plant additions forecast involved reviewing the entire balance of projected plant additions requested by the Company based on a historical comparison of budgeted and actual plant additions using Year-to-Date ("YTD") actual information through October 2011. The historical information analyzed by Staff indicated that for the 70 month period covering calendar years 2006 through 2010 and January 2011 through October 2011, actual plant additions averaged only 96% of total budgeted plant additions (on a non-jurisdictional basis). (Staff IB, p. 23)

Also contrary to statements in the Company's IB (ComEd IB, p. 35), Staff's analysis does account for changes in cost drivers. Staff's analysis of the projected plant additions incorporates "multiple and dynamic considerations" ultimately relied upon in the Company's models, processes, and procedures used in developing its plant additions budgets. (Staff IB, p. 24) Therefore, Staff's analysis of the Company's

historical forecasts properly considers the Company's forecasting accuracy and thus should be used in the evaluation of future projections. (*Id.*)

Finally, the Company claims incorrectly that Staff's five-year average variance calculation is unreliable because Staff included 2009 data. (ComEd IB, p. 36) The Company provided no evidence to support this claim. As Staff pointed out in rebuttal testimony, ComEd did not provide 2009 budget versus actual information by category (e.g. New Business) because, as part of the Company's standard budgeting and variance analysis process, the Company does not budget or forecast plant additions at the category level. (Staff Ex. 16.0, Ln. 171-182; p. 8, fn. 1) Clearly, there was no basis for any claim that 2009 data was somehow aberrational consequent to levels of new business, as the Company was unable to offer any surrebuttal testimony to rebut Staff's observation.

As Staff explained in its IB, the comparison of historical actual to budget plant additions provides the Commission an objective method of determining the reasonableness of projected plant additions, allowing the Commission to observe past trends independent of the analyses provided by the Company, and should not be dismissed. (Staff IB, p. 23) Staff presented a process to evaluate the aggregate forecast which could be employed by the Commission in not only the current proceeding, but also in similar future proceedings. (Staff IB, p. 24) Staff's method of evaluating the reasonableness of the projected plant additions incorporates the multiple and dynamic considerations ultimately relied upon in the Company's models, processes, and procedures used in developing its plant additions budgets. As such, an analysis of the Company's historical forecast accuracy is illustrative of how its past

forecasts have fared compared to actual results, and therefore should be used in the evaluation of future projections. (*Id.*) Staff's analysis showed that the Company averaged only 96% of total budgeted plant additions for the 70 month period ending October 31, 2011. (*Id.*, p. 23) Considering the entirety of the evidence set forth in testimony and briefs, Staff's adjustment to reduce 2011 projected plant additions should be adopted by the Commission.

**d. Derivative: Restricted Stock**

**e. Derivative: Incentive Compensation**

**f. Derivative: Perquisites and Awards**

**3. Accumulated Depreciation & Amortization**

The derivative impacts of Staff's adjustments are included within each of Staff's adjustments. Staff recommends that the Commission adopt Staff's adjustments in their entirety. However, if in adopting Staff's adjustments the Commission amends Staff's adjustments or otherwise adopts other adjustments, the derivative impact of those changes or other adjustments on accumulated depreciation and amortization should be reflected in a manner consistent with the way in which the Commission decides those underlying issues. (Staff IB, p. 25)

**4. Cash Working Capital Issues**

Staff's recommended cash working capital ("CWC") requirement is based on the record evidence in this proceeding and is consistent with the Commission's most recent Order in Docket No. 10-0467. The facts and issues in this proceeding with regard to this issue are consistent with those considered by the Commission in Docket No. 10-

0467, and the evidence presented does not lead to a different conclusion from that Docket.

**a. Revenue Collections Lag**

The Company concludes that revenue lag of 51.25 days for pass-through taxes is supported by the evidence. (ComEd IB, p. 39) The Company's conclusion could not be more incorrect. The evidence clearly shows that pass-through taxes are not revenue and that pass-through taxes are funded by ratepayers. (Staff IB, pp. 26-27) Pass-through taxes are not revenue to the utility and are not included in the revenue requirement. (Staff Ex. 3.0, p. 5) A revenue lag should not be applied to things which are not revenue. (*Id.*, p. 6)

Applying a revenue lag to pass-through taxes increases CWC, thereby increasing rate base. The result is that ratepayers would pay a higher rate to finance pass-through taxes, even though pass-through taxes are funded by ratepayers. (*Id.*)

**b. Pass-Through Taxes**

The Company attempts to argue that the statutory requirement to include some pass-through taxes as charges in its bills to customers somehow mandates that pass-through taxes must have a revenue lag. (i.e. "The Energy Assistance Charge assessed by electric and gas public utilities shall be considered a charge for public utility service.") (305 ILCS 20/13(e)) The statutory language that the tax is to be considered a charge for public utility service does not address whether it is appropriate to include the pass through tax in a revenue lag for a CWC calculation. The statutes contain no language concerning CWC. Passing tax revenues from the ratepayer through the utility to the taxing authority, even if done through the ratepayer's monthly utility bill, does not

change the nature of pass-through taxes. The method by which pass-through taxes are passed along does not transform them into a source of revenue for the utility.

The Company maintains that its election to remit pass-through taxes earlier than required justifies a revenue lag. As Staff pointed out in its IB, Ratepayers should not be penalized for decisions made by the Company for its own benefit. (Staff Ex. 15.0, p. 4; Staff IB, p. 28) The Commission should not accept the Company's argument as a reason to increase the Company's CWC.

The Commission should not consider the Company's discussion of Docket No. 11-0282, Ameren Illinois Company's ("AIC") proposed general increase in natural gas rates, in its decision. A relationship between the pass-through tax remittance of AIC's gas utility operations and ComEd's electric utility operations has not been established in this proceeding. Staff is not recommending that the Company change its remittance schedule. Staff is recommending an adjustment to CWC so ratepayers are not penalized for decisions made by the Company for its own benefit. The Company has not discussed this issue with the City of Chicago or other municipalities. (*Tr.*, March 8, 2012, p. 236) What the Company might or might not negotiate with the various taxing authorities in the future is too uncertain to be considered.

**c. Intercompany Billing Lead**

Staff's recommended expense lead days for intercompany obligations is consistent with the Final Order in the Company's most recent rate case, Docket No. 10-0467. The Company's process for paying intercompany obligations has not changed since Docket No. 10-0467. Given that, there is no reason for the Commission to reach a conclusion here different than that in the Company's most recent rate case. (Staff Ex.

3.0, pp. 14-15) The Company's argument that expense lead days recommended by Staff and interveners are longer than other utilities is not relevant. Staff's calculation is based on the evidence in the instant proceeding.

**d. Employee Benefits – Pension and OPEB Lead**

**e. Accounts Payable Related to CWIP**

**f. 401(k) Match**

**g. Impact of Current and Deferred Taxes**

The Company's contention that Staff did not present rebuttal on this issue (ComEd IB, p. 43) does not take into account Staff's rebuttal schedule in which Staff included State and Federal income tax expenses in Staff's CWC calculation. (Staff Ex. 13.0, Schedule 13.01, column (i), lines 19 and 20; and Staff Ex. 15.0, Schedule 15.01 Revised, p. 1, column (b), lines 26 and 27) Staff's CWC calculation includes negative current income tax expenses which represent a benefit to the Company attributable to the current period; thus their inclusion in the revenue requirement. Staff's CWC calculation is consistent with prior Commission practice of including all cash operating expenses included in the revenue requirement. The Final Order in the Company's most recent rate case, Docket No. 10-0467, included negative Federal income tax expense which increased CWC. (Order, May 24, 2011, Docket No. 10-0467, Appendix A, p. 17, line 27)

**h. ComEd Proposal re Timing of Future Lead/Lag Study**

**5. Accumulated Deferred Income Taxes**

**a. 2011 Plant Additions**

Staff affirms its recommendation that the Commission find that Accumulated Deferred Income Taxes ("ADIT") on 2011 projected plant additions is not appropriate for

inclusion in the determination of the delivery services rates set by the performance-based formula rate, as recommended by Staff and the Company. (Staff IB, p. 34)

**b. Bad Debt Reserve**

Staff continues to recommend that the Commission adopt the Intervenor and Staff adjustments to allocate ADIT associated with bad debt reserve to distribution services the same way the uncollectible expense that gave rise to that ADIT is allocated. The Company proposal to allocate ADIT associated with bad debt reserves 100% to distribution services should be rejected, as it would lead to ADIT associated with bad debts reserve being allocated differently from the bad debts that gave rise to the ADIT amount at issue.<sup>2</sup> (Staff IB, pp. 34-35; Staff Ex. 16.0, pp. 23-25)

The Company continues to cloud the issue in its IB, arguing that the Intervenor positions are in direct contrast with their past positions on late payment charges, and also arguing that if not recovered in delivery services charges, the ADIT associated with bad debt reserve will not be recovered elsewhere. (ComEd IB, p. 46) The Company again criticizes Staff and Intervenor for what the Company characterizes as a failure to address the discrepancy between the allocation of late payment charges and ADIT associated with bad debt reserve and failure to suggest alternatives of how ComEd should actually recover the ADIT cost. (*Id.*) Through all of its criticisms, however, the Company fails to offer any explanation regarding why ADIT associated with a particular item should not be allocated in the same manner by which the item itself is allocated. The Commission should focus its attention on this point, not the claimed discrepancy

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<sup>2</sup> Bad debt expense that gave rise to ADIT on bad debt reserve was allocated by the Company to distribution services using the Revenue Allocator of 34.87%, as opposed to the 100% allocation proposed by the Company for ADIT related to Bad Debt Reserve. (Staff Ex. 16.0, p. 24)

with Intervenor positions in a prior proceeding, and not the claim that the Company's existing tariffs would not allow it to recover a small amount of ADIT absent additional Company action. In this instance, consistency means the ADIT should follow the allocation of the uncollectibles expense that gave rise to it.

The Staff and Intervenor adjustments to allocate ADIT associated with bad debt reserve using the same methodology as used by the Company to allocate bad debt expense which ultimately gave rise to the ADIT amount should be adopted by the Commission.

**c. Vacation Pay**

Staff affirms its recommendation that the Commission include in rate base ADIT associated with vacation pay (after appropriate jurisdictional allocation). (Staff IB, pp. 37-38)

As stated in Staff's IB, the Commission should remain consistent with prior orders and find that the entire jurisdictional balance of ADIT, including jurisdictional ADIT associated with vacation pay, be included in rate base. (Staff IB, p. 38)

**d. Incentive Pay**

Staff affirms its recommendation that the Commission include in rate base ADIT associated with incentive pay (after appropriate jurisdictional allocation), as recommended by Staff and the Company. (Staff IB, pp. 38-39)

As stated in Staff's IB, the Commission should remain consistent with prior orders and should find that the entire jurisdictional balance of ADIT, including jurisdictional ADIT associated with incentive pay, be included in rate base. (Staff IB, p. 39)

**e. FIN47**

Staff affirms its recommendation that the Commission should include in rate base ADIT associated with FIN47 (after jurisdictional allocation), as recommended by Staff and the Company. (Staff IB, pp. 39-40)

The Commission should remain consistent with prior orders and should find that the entire jurisdictional balance of ADIT, including jurisdictional ADIT associated with FIN47, be included in rate base. (Staff IB, p. 40)

**6. Operating Reserves**

**a. Accrued Vacation Pay**

Staff affirms its recommendation that the Commission adopt the Intervenor and Staff adjustments to include in operating reserves as a reduction to rate base the liability for accrued vacation pay. (Staff IB, pp. 40-42)

Contrary to the Company's claims (ComEd IB, p. 49), the reserve for accrued vacation pay should be included in operating reserves as a reduction to rate base because a constant balance of non-investor funds are held in reserve for accrued vacation pay. (Staff IB, p. 41) The Company proposed cash working capital revisions for accrued vacation pay, but the Company's revisions fail to account for the entire accrued vacation pay reserve. The Company's revisions reflect in its cash working capital calculation only a small portion of the total vacation pay reserve that should be included in rate base. The record clearly shows that the amount of reserve for accrued vacation pay accounted for in the Company's cash working capital study does not adequately account for the total amount held in reserve, and that Staff's adjustment appropriately includes the remaining amount. (*Id.*)

Furthermore, the Company argument that it has removed from rate base the ADIT debit balance associated with the vacation pay accrual, (ComEd IB, p. 48), is moot, as the Commission's prior practice has been to require that all jurisdictional ADIT be included in rate base. As discussed in Section III.C.5.c and Section III.C.5.d above, the Commission should remain consistent with prior practice, and require that all jurisdictional ADIT be included in rate base.

The Company also argues that Staff and Intervenor witnesses were not aware of any past instances in which rate base reductions were recommended or approved for a utility's accrued vacation pay reserve. (ComEd IB, p. 49) However, neither did the Company point to any instances where any similar recommendations have been rejected by the Commission, or any other jurisdiction. If the Company is aware of any such instances, those instances should have been referenced in testimony where Staff and Intervenors could respond to any such instances on the record.

Staff maintains its position that in the case of the reserve for accrued vacation pay, a constant balance of non-investor funds are held in reserve; as such, the entire reserve for accrued vacation pay should be included in operating reserves as a reduction to rate base. Further, Staff maintains its position that if ADIT is included in rate base, the associated reserve which gives rise to that ADIT must also be included in rate base. (Staff IB, pp. 41-42) The Commission should adopt Staff's and AG/AARP's adjustments to include the reserve for accrued vacation pay in rate base.

#### **b. Accrued Incentive Pay**

For the same reasons stated in Section III.C.6.a above, Staff affirms its recommendation that the Commission should adopt the Intervenor and Staff

adjustments to include in operating reserves as a reduction to rate base the liability for accrued incentive pay. (Staff IB, pp. 42-43) The Staff and AG/AARP adjustments to include the reserve for accrued incentive pay in rate base should be adopted by the Commission.

**7. Other**

**IV. REVENUES**

**A. Potentially Uncontested Issues**

**1. Correction to Lease/Rental Revenues**

**B. Potentially Contested Issues**

**1. Late Payment Charges Revenues Allocation**

**2. New Business and Billing Determinants**

**3. Other**

## **V. OPERATING EXPENSES**

### **A. Overview**

### **B. Potentially Uncontested Issues**

- 1. Distribution**
- 2. Customer Accounts Expenses Other Than Uncollectibles, Including Staff Proposal re Interest on Customer Deposits (see also III.B.5)**
- 3. Uncollectibles Expense and Staff Rider Proposal**
- 4. Customer Service and Informational Expenses**
- 5. Adjustments for Ratemaking, Other Tariffs, Past Orders, and Other**
- 6. Administrative and General Expenses**
  - a. Regulatory Commission Expense**
  - b. Transmission-Related Research and Development**
  - c. Sporting Event Activities**
  - d. Outside Services**
  - e. Correction of Error Relating to Rider EDA**
  - f. Photovoltaic Pilot Costs**
- 7. Regulatory Asset Amortization: Unusual Operating Expenses, Including Storm Costs**
- 8. Pension Asset Funding – SERP ADIT Component (see also III.B.2.a)**

As discussed in Staff's IB, subject to Staff's other recommendations regarding pension costs and pension asset stated here within, Staff does not oppose the inclusion of SERP ADIT in the calculation of pension funding cost as discussed in AG/AARP Ex. 2.0R, pp. 6-7 and ComEd Ex. 13.0, p. 11. (Staff IB, p. 4, 47)

**9. Income Taxes Other Than Interest Synchronization**

**10. Depreciation & Amortization Expense, Including Staff's Withdrawn Proposal Regarding a Future Study (Other than Derivative Impacts)**

In its IB, the Company stated that Staff's adoption of the alternate proposal of calculating depreciation and amortization expense is reflected in Staff Ex. 16.0, Schedule 16.04. (ComEd IB, pp. 57-58) As a matter of clarification, Staff notes that as reflected in ComEd-Staff Group Cross Ex. 1, p. 19, Staff withdrew its Schedule 16.04, as the schedule was duplicative of calculations included in Staff Exhibit 16.0, Schedule 16.01.<sup>3</sup>

**11. Staff Proposal for Finding Regarding Non-Inclusion of Rate Case Expense in Initial Rates**

**12. Gross Revenue Conversion Factor**

**C. Potentially Contested Issues**

**1. Administrative and General Expenses**

**a. Total**

**b. Restricted Stock**

The Commission should disregard the Company's arguments that the costs of restricted stock should be recoverable from ratepayers through the formula rate. In its IB, the Company claims that the Key Manager Restricted Stock Award program is not an incentive compensation program. (ComEd IB, p. 60) The Company contradicts its own claim, however, by including the details of this program in ComEd Ex. 4.9 which "provides a summary of ComEd's 2010 incentive compensation costs and the

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<sup>3</sup> As previously noted, Staff Schedule 16.01 was subsequently revised as set forth in ComEd-Staff Group Cross Ex. 1, pp. 5-9.

jurisdictional amount included in ComEd's revenue requirement." (ComEd Ex 4.0, p. 5, lines 110 – 111) Also, the Commission considered the Restricted Stock Program a component of ComEd's incentive compensation program when it disallowed the program in ComEd's last rate case, Docket No. 10-0467. (Order, Docket No. 10-0467, May 24, 2011, p. 65) Therefore, contrary to ComEd's arguments, the protocols for the recovery of incentive compensation costs do apply to these costs.

The Commission has already found these costs to not be recoverable in delivery service rates in Docket No. 10-0467. Further, Section 16-108.5 of the Act specifically states both that costs not otherwise recoverable are not recoverable only by their inclusion in FERC Form 1, and that the review of the Company's filing is to "be based on the same evidentiary standards, including, but not limited to, those concerning the prudence and reasonableness of the costs incurred by the utility, the Commission applies in a hearing to review a filing for a general increase in rates under Article IX of this Act." (220 ILCS 5/16-108.5(c)) Therefore, the Commission should accept Staff's adjustment.

### **c. Incentive Compensation**

#### **BSC Annual Incentive Plan Cost Allocation**

The arguments offered by ComEd against Staff's disallowance of 75% of the BSC incentive compensation costs do not fully consider the appropriate sections of the Act. With respect to the BSC Incentive Compensation costs included in the revenue requirement, ComEd argues that it is unnecessary and improper to interpret Section 16.108.5(c)(4)(A) as providing review of transactions between affiliates and public utilities when the Act has already provided for that review in Section 7-101. (ComEd IB,

pp. 62-63) In making this argument, ComEd completely ignores the following subsection of Section 7-101:

(3) No management, construction, engineering, supply, financial or similar contract and no contract or arrangement for the purchase, sale, lease or exchange of any property or for the furnishing of any service, property or thing, hereafter made with any affiliated interest, as hereinbefore defined, shall be effective unless it has first been filed with and consented to by the Commission or is exempted in accordance with the provisions of this Section or of Section 16-111 of this Act. The Commission may condition such approval in such manner as it may deem necessary to safeguard the public interest. If it be found by the Commission, after investigation and a hearing, that any such contract or arrangement is not in the public interest, the Commission may disapprove such contract or arrangement. Every contract or arrangement not consented to or excepted by the Commission as provided for in this Section is void.

The consent to, or exemption or waiver of consent to, any contract or arrangement under this Section or Section 16-111, does not constitute approval of payments thereunder for the purpose of computing expense of operation in any rate proceeding. However, the Commission shall not require a public utility to make purchases at prices exceeding the prices offered by an affiliated interest, and the Commission shall not be required to disapprove or disallow, solely on the ground that such payments yield the affiliated interest a return or rate of return in excess of that allowed the public utility, any portion of payments for purchases from an affiliated interest.

(220 ILCS 5/7-101(3) (emphasis added))

In addition, Section 16.108.5(c)(4)(A) specifically addresses incentive compensation based on an affiliate's earnings per share:

Incentive Compensation expense that is based on net income or **an affiliate's earnings per share** shall not be recoverable under the performance-based formula rate;

(220 ILCS 5/16-108.5(c)(4)(A) (emphasis added))

Therefore, the adjustment to disallow 75% of the BSC incentive compensation costs should be approved.

ComEd AIP Costs above Target

With regard to the AIP Costs above target, the issue is whether the Company should be able to recover expenses above the initial net income limiter. (Staff Ex. 13.0, pp. 18-19) The rationale offered by ComEd, that Staff's proposal to not allow manipulation of the net income limiter that establishes a criterion for the payout of AIP incentive compensation, should not be given significance. ComEd mischaracterizes both Staff's and CUB's adjustments for AIP incentive compensation costs as normalization adjustments and then proceeds to argue that normalization adjustments are not required since rates will be re-set annually. (ComEd IB, p. 64) It is true that rates being set currently will be trued up in later reconciliations. But by allowing the net income limiter to be adjusted, as the Company did in 2010, ComEd would be able to shift money from one incentive compensation plan to another, as it did in 2010 (Staff Ex. 13.0, pp. 18-19), which increases the amount of incentive compensation payout which in turn would increase rates. As Staff explained in testimony, this manipulation of the net income limiter circumvents any protections built into the incentive compensation plan rendering those protections ineffective. (Staff IB, pp. 49-50) Setting rates which disregard the protections built into the plan by allowing the plans to be manipulated necessarily means that the "protections" afforded by the net income limiter will likewise be disregarded in future periods. The Commission should accept Staff's adjustment which provides for the protections of the net income limiter to be effective and not manipulated.

#### **d. Perquisites and Awards**

The Company has provided no new arguments to support the recoverability of performance based awards through the formula rate. The Company continues to argue

that customers benefit from a higher level of service as a result of the performance based awards. (ComEd IB, p. 67) The Company chooses to ignore the Act which states:

Nothing in this Section is intended to allow costs that are not otherwise recoverable to be recoverable by virtue of inclusion in FERC Form 1.  
(Section 16-108.5(c)(6))

and that the evaluation of the Company's filing is to be :

based on the same evidentiary standards, including, but not limited to, those concerning the prudence and reasonableness of the costs incurred by the utility, the Commission applies in a hearing to review a filing for a general increase in rates under Article IX of this Act  
(220 ILCS 5/16-108.5(c))

The Commission has previously found these costs for perquisites and awards for ComEd to be unrecoverable. (Order, May 24, 2011, Docket No. 10-0467, p. 103) The Commission should disallow these same costs consistent with the treatment approved in the prior rate case.

**e. W&S Allocator Calculation (see also III.C.2.b.2)**

**f. Charitable Contributions**

The Commission should accept Staff's proposed adjustment to remove from the Company's revenue requirement charitable contributions that do not meet the criteria established in Section 9-227 of the Act. The Company asserts that Staff's definition of the term "public welfare" is a narrower interpretation of the Act than that of the Company. (ComEd IB, p. 71) The Company has provided a definition for public welfare from Black's Law Dictionary. According to the Company, Black's Law Dictionary defines public welfare as, "[a] society's well-being in matters of health, safety, order, morality, economics, and politics." (ComEd IB, p. 72) Even using this definition, the contributions

which Staff proposes to disallow would not be recoverable. Contributions made for Arts and Culture (total \$1,712,000) (Staff Ex. 6.0, Schedule 6.01, p. 2, Lines 1- 47), such as donations of \$95,000 to the Chicago Symphony Orchestra (Staff Ex. 6.0, Schedule 6.01, p. 2), which represents approximately 56% of Staff's proposed disallowance (Arts and Culture disallowance \$1,712 / Total disallowance \$3,079 = 56%) (Staff Exhibit 6.0, Schedule 6.01 p.1) cannot reasonably be interpreted to be for health, safety, order, morality, economics, or politics.

The Company has also noted that donations to community and economic development organizations have not previously been denied to ComEd.

In addition, Mr. Tolsdorf entirely disallows donations to community and economic development organizations, incorrectly stating that "the Commission has routinely disallowed these types of donations for recovery." (ComEd IB, p. 72)

Contrary to the Company's assertion, Mr. Tolsdorf is correct about the Commission's prior disallowances. In direct testimony, Staff cited several dockets where the Commission disallowed donations for community and economic development organizations. (ICC Staff Exhibit 6.0, p. 5) Mr. Tolsdorf did not state that recovery for these donations had previously been denied to ComEd, but was pointing out that they had previously been denied to other gas, water and electric utilities in Illinois. Staff has provided evidence in this proceeding that such contributions do not meet the criteria set forth in Section 9-227 (Staff Ex. 6.0, pp. 3-6) and ComEd has provided no evidence or reasonable basis for why it should be treated differently than other utilities operating in Illinois.

Regarding contributions made to out of state organizations, the Company mischaracterizes Mr. Tolsdorf's testimony by stating that Mr. Tolsdorf suggested an

administrative rule for disallowing donations to out of state institutions be adopted. (ComEd IB, p. 73) In fact, Staff Counsel repeatedly objected to this same mischaracterization of Mr. Tolsdorf's testimony during his cross-examination. While it is correct that ComEd's Counsel attempted to suggest Staff recommended a rule, nothing in Mr. Tolsdorf's testimony suggests that recommendation. (*Tr.*, March 13, 2012, pp. 801-802) Mr. Tolsdorf, consistent with Section 9-227, found that the contributions to out of state organizations were not reasonable. (*Id.*, p. 802) As staff set forth in Staff's IB (Staff IB, p. 52), such a position is consistent with the Commission's order in ComEd's last rate case. ("The Commission concurs with Staff's proposal to disallow charitable contributions made by ComEd to organizations outside of the Company's service territory. There is no evidence that these contributions provide any benefit to ratepayers in ComEd's service territory. The Commission agrees with Staff that it is not reasonable to require ComEd ratepayers to bear the cost of such contributions. ") (Order, Docket No. 10-0467, May 24, 2011, p. 108)

**g. Advertising Expense**

The Commission should accept Staff's proposed adjustment to disallow the Company's advertising costs which are goodwill in nature and incremental to the Company's historical expenditures for conservation of energy advertising. The Company argues that including these costs in the Rider EDA calculations for Plan Year 2 would not have significantly affected the TRC calculation for PY2. (ComEd IB, p. 75) However, the Company ignores the fact that the proper place to recover these costs is through the recovery mechanism for which they were intended, regardless of the calculation outcome. The Company has established a separate tracking rider

mechanism, Rider EDA, to recover the costs associated with energy efficiency. Even if the costs in question are energy conservation advertising as the Company claims, then the proper place for recovery is through its Rider EDA. However, Staff still maintains that these particular costs are goodwill advertising and should not be included for recovery under any recovery mechanism.

## **2. Depreciation and Amortization Expense (Derivative Impacts)**

The derivative impacts of Staff's adjustments are included within Staff's adjustments. Staff recommends the Commission adopt Staff's adjustments in their entirety. However, if in adopting Staff's adjustments the Commission amends Staff's adjustments or otherwise adopts other adjustments, the derivative impact of those changes or other adjustments on depreciation and amortization expense should be reflected in a manner consistent with the way in which the Commission decides those underlying issues. (Staff IB, p. 54)

## **3. Taxes Other Than Income, Including Property Taxes**

## **4. Regulatory Asset Amortization: IEDT**

CUB-City continues to recommend an amortization period of three years versus a five year amortization period for IEDT credits that ComEd used in the formula rate in accordance with Section 16-108.5 (c)(4)(f). (CUB-City IB, pp. 39-40) Staff and ComEd remain opposed to CUB-City's amortization proposal. ComEd acknowledged that Section 16-108.5(c)(4)(f) does not specifically state that an IEDT credit related to credits yet to be received should be amortized over five years. However, since the credit's total of \$38.980 million is in excess of \$10 million and is a one time unusual adjustment, ComEd believes that the credit meets the spirit of the legislation and should be

amortized over five years. (ComEd IB, pp. 79-80) As was stated in Staff's IB, Staff continues to recommend that the Commission find as prudent and reasonable costs of (\$7.796) million as an unusual operating expense and the unamortized IEDT credits of (\$31.184) million with deferred tax impact of \$12.394 million which are reflected in rate base. This reflects the five-year amortization proposed by ComEd. (Staff IB, pp. 54-55)

## **5. Pension Costs**

### **a. Pension Asset Funding**

The Company's discussion of the Pension Costs issue is fraught with misstatements and hyperbole which must be addressed. As anticipated by Staff in its IB (Staff IB, p. 56), ComEd, consistent with Ms. Houtsma's testimony, has taken the position that the Commission has no discretion to consider Staff's definition of pension asset. ("...if the Commission rejects Staff's recommendation to deny recovery on ComEd's pension asset, as it must,...") (ComEd IB, p. 8 (emphasis added)) ComEd has also threatened legal action if the Commission were to adopt Staff's position. ("...[Staff's] interpretation would ignite years of litigation and uncertainty ..."). (ComEd IB, p. 7 (emphasis added)) The Commission should reject ComEd's tactics and freely consider the merits of Staff's position. As Staff set forth in its IB, the Commission should take a fresh look at the pension issue in light of the fact that well over five years after the Commission allowed the Company a return on its special pension contribution, the Company still has never committed to fully funding its share of the pension plan by a date certain and the other large utility in northern Illinois, Nicor Gas, has been able to achieve a fully-funded pension plan without a Commission-provided incentive (Staff IB, pp. 63-64) which the Company argues for in this case. (ComEd IB, p. 90)

In its introduction on page 83 of its IB, the Company sets forth six items that it alleges were present in its three previous rate filings identified as ComEd 2010,<sup>4</sup> ComEd 2007<sup>5</sup> and ComEd 2005.<sup>6</sup> Staff responds to those details as follows:

- 1) According to ComEd, “the Commission approved recovery of at least \$25 million related to the cost of funding the pension plan.” ComEd’s statement is misleading. The \$25 million that was approved in ComEd’s three previous rate filings was NOT related to meeting the minimum funding requirements (normal contributions) of the plans but was related to excess/special contributions to the plans. (*Tr.*, March 9, 2012, pp. 457-460) While Staff could agree that at least \$25 million related to excess pension contributions was approved in each of the three cited cases, those excess contributions were over and above the normal quarterly contributions which the Company was required to make to the pension plan each year. (*Tr.*, March 13, 2012, pp. 903-904) ComEd’s statement ignores the fact that the Commission did not approve a return on those *normal* quarterly contributions for ComEd 2010, ComEd 2007, and ComEd 2005 (*Id.*) which the Company’s statement could be interpreted to mean.
- 2) According to ComEd, it “had a ‘pension asset’ properly recorded in its financial statements in its FERC Form 1.” In the context in which this statement is made it is misleading. While ComEd may certainly have had a

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<sup>4</sup> Staff assumes that “ComEd 2010” is Docket No. 10-0467, Order dated May 24, 2011

<sup>5</sup> Staff assumes that “ComEd 2007” is Docket No. 07-0566, Amendatory Order dated November 3, 2008; Original Order dated September 10, 2008.

<sup>6</sup> Staff assumes that “ComEd 2005” is Docket No. 05-0597, Corrected Order on Re-hearing dated December 20, 2006; Original Order dated July 26, 2006.

- “pension asset” recorded in its financial statements and FERC Form 1, the Commission did NOT establish a pension asset in the approved revenue requirements in the three prior cited cases. (*Tr.*, March 9, 2012, pp. 457-460)
- 3) According to ComEd the Commission allowed a recovery “based on long-term debt.” This statement is also misleading. The Commission did *not* provide recovery on the excess pension based simply on the long-term debt in all three cases. In ComEd 2005, the Commission allowed a return based on specialized financial analysis that differed from the weighted average cost of debt reflected in the Company’s weighted average cost of capital. (Commission Order on Rehearing, Docket No. 05-0597, December 20, 2006, pp. 7, 25, and 28) In ComEd 2007, the Commission included the same amount in the revenue requirement that it included in ComEd 2005 without considering any change to the cost of debt or balance of the excess contribution in between the two rate cases. Finally, in ComEd 2010, the Commission allowed a debt return on a reduced amount from ComEd 2005 and limited recovery of the new excess contribution only to the extent it produced a reduction in pension expense. (*Tr.*, March 9, 2012, pp. 457-460) When these three cases are taken together, it is not accurate to say that the Commission simply allowed a long-term debt return on the excess contributions to the pension plan. And, in all three cases, long-term debt was only applied to a portion of the excess pension contributions, not the total excess pension contributions remitted. (*Id.*)

- 4) According to ComEd “the cost recovery approximated the dollar value of customer benefits resulting from contribution, in the form of reduced pension expense.” In the context in which this statement is made, it is misleading. Cost recovery on the excess pension contributions did NOT approximate the dollar value of customer benefit in these three cited cases. While the customer benefit through decreased pension expense was a factor that was considered in the Commission’s conclusion in ComEd 2005 and ComEd 2010, the cost recovery did not “approximate” the dollar value of resulting reduced pension expense.
- 5) According to ComEd, “ComEd’s pension plan was underfunded in the sense that its future obligations to plan participants were greater than the fair value of plan assets.” ComEd’s statement is not completely accurate and tells only half the story. With regard to ComEd 2005 case, after ComEd made its special contribution the plan was fully funded. The plan was neither underfunded nor over funded. (*Tr.*, March 9, 2012, p. 412) In addition, when ComEd states the plan was underfunded ComEd ignores the fact or fails to state that ComEd was NOT behind on its required funding obligations when it made these excess contributions. Furthermore, there is no evidence that shows ComEd will fail to meet its funding obligations without making the excess contributions. In fact, ComEd’s pension plan was fully-funded for a short time as a result of the 2005 pension contribution that was the basis for the pension funding cost included in the ComEd 2005 revenue requirement.

6) According to ComEd, “the contribution was deemed to be a prudent investment and a legitimate cost of delivery service.” ComEd’s statement is misleading. The Commission did NOT explicitly find that the excess pension contributions were prudent in ComEd 2010. Staff would agree that the Commission did not find that the excess pension contributions in 2005 and 2009 were imprudent. Staff asserts that it is reasonable to assume that by the inclusion of costs in the final orders in ComEd 2010, ComEd 2007, and ComEd 2005 those costs were legitimate cost of delivery service. However, the ComEd 2010 order does not include a statement by the Commission that the excess pension contributions were prudent. Staff would further point out that no where does its witness testify to having conducted a prudence analysis of the Company’s pension contributions. In fact, Ms. Ebrey, with regard to the pension asset, states she did not perform a prudence analysis. (*Tr.*, March 9, 2012, p. 419)

ComEd goes on to argue that Staff’s position is contrary to the plain language of the statute, that it is implausible that the General Assembly would have enacted a law that would dramatically alter existing Commission practice, and that adopting Staff’s position would be poor public policy. (ComEd IB, pp. 83-84) As Staff argued in its IB, it is clearly evident from the plain language of the statute that the General Assembly left it up to the Commission to define a pension asset. Section 16-108.5 does not mandate that the Commission must use whatever amount appears on ComEd’s FERC Form 1 as a pension asset. The only mandate is how the investment return on the pension asset is to be determined. ComEd’s argument ignores the fact that while the legislature chose

in Section 16-108.5 to define the investment return on the pension asset as the “utility's long-term debt cost of capital as of the end of the applicable calendar year” it is telling that the legislature also chose to not provide a definition for the pension asset, leaving it up to the Commission to define a pension asset. (Staff IB, p. 56) In response to ComEd's argument that Staff's proposal would alter existing Commission practice, Staff addressed that point in its IB. Staff discussed that while the Commission has addressed the issue of a pension asset on several occasions in prior ComEd rate proceedings, the Commission: (1) has never defined it consistently; (2) has never defined it as ComEd suggests in this proceeding; and (3) has never found ComEd to even have a pension asset. (Staff IB, p. 57) There is simply no existing consistent Commission practice as ComEd suggests. Finally, as to the public policy of granting ComEd an incentive to fund its pension plan in excess of the contributions required by ERISA, ComEd has never explained what is so special about it. As Staff pointed out above and in its IB at length, the incentive is not working for ComEd, and Nicor Gas has been able to achieve a fully funded pension with normal pension contributions.

Staff's position is that the Commission should not continue to provide the Company an incentive to fund its pension plan (ComEd IB, p. 90) above the minimum required funding level. The Commission needs to revisit the incentive that was initially provided to ComEd in its rate order in Docket No. 05-0597. The incentive has not been successful. ComEd's share of the plan has gone from fully-funded back in ComEd 2005 (*Tr.*, March 9, 2012, p. 412) to only 68.2% funded in this docket while Nicor Gas has been able to achieve a fully funded pension plan without such an incentive. (Staff IB, pp. 63-64) Staff's proposal allows recovery of the legally required pension contributions

needed to adequately fund the pension plan over time. Staff's proposal removes the incentive to make additional discretionary contributions that increase delivery service rates. In fact, when making pension funding decisions, management considers the minimum required funding level and not a maximum funding level as a significant factor to set forth in ComEd's financial statements regarding the funding of the pension plan:

management considers various factors when making pension funding decisions, including actuarially determined **minimum contribution requirements** under ERISA, contributions required to avoid benefit restrictions and at-risk status as defined by the Pension Protection Act of 2006, ...

(*Tr.*, March 13, 2012, p. 923; Staff Cross Ex. 8, (Annual Report p. 117) (**Emphasis** added)

No one claims that ComEd should have a fully-funded pension plan in 2010. While ComEd cites to the testimony of the union president to support its argument that accepting Staff's position would be harmful to its employees, ComEd in its collective bargaining agreement with the IBEW Local 15 is not required to fully fund the pension plan by a certain date. (*Tr.*, March 12, 2012, p. 663) Given that fact, the credibility of the claims made by ComEd and the IBEW come into question. Finally, counsel for ComEd even stated on the record that "[w]ell there's no commitment that ComEd would fully fund its Pension Plan." (*Tr.*, March 12, 2012, p. 665) Because ComEd has not obligated itself to make pension plan contributions above the minimum required by law, the incentive the Commission allowed the Company back in Docket No. 05-0597 no longer is appropriate. (Staff IB, pp. 63-63)

Throughout its IB, the Company claims that the recovery it seeks in rates for a return on its pension asset (\$34.871 million) is less than the customer benefit/reduced pension expense (\$61 million) (ComEd IB, p. 83, 85, 89, and 90) and then concludes its

arguments on the issue by again citing to the alleged customer benefit and argues that it should be given an incentive to remedy the underfunded status of its pension plan. (ComEd IB, p. 90) When the customer benefit statements are combined together with the argument that ComEd should be given an incentive to fund its pension plan, it is misleading to the Commission for the following reasons. First, ComEd fails to point out or acknowledge that the \$61 million figure is based not only upon special contributions but also normal contributions. (ComEd Ex. 12.3; ComEd Cross Ex. 12) Second, ComEd's own witness Mr. William Graf testified that both normal contributions and special contributions as well as earnings on trust funds reduce pension costs and expense. (ComEd Ex. 14.0, p. 4) Third, the Commission in its prior orders when it addressed customer benefit of pension contributions was only concerned with calculating the customer benefit attributed to the Company's special contributions. Normal contributions and earnings on trust funds were not considered by the Commission since those were due to ratepayer contributions. Therefore, it is misleading for ComEd to argue in its brief that the customer benefit of its pension contributions is \$61 million when it makes that argument in the context of the Commission providing ComEd an incentive to fully fund its pension plan. Staff questioned the validity of the \$61 million during cross examination. (*Tr.*, March 9, 2012, pp. 436 – 439) and the Commission should do the same. Staff would further note that the calculations on Attachment E (Staff Ex. 1.0, Attachment E) discussed during Staff witness Ebrey's cross examination were based on the excess pension contributions made in 2010, while the calculations on ComEd Ex. 12.3 included not only the excess contributions made in 2005 and 2009, but also all of the normal quarterly contributions

made during the period 2003 through 2009. While the calculation on ComEd Ex. 12.3 uses the same percentage factors in the calculation, Staff does not agree that the bases for the calculations are sufficiently similar. If the Commission wants to compare the \$34.871 million figure to a customer benefit figure, which it should not, the appropriate figure in evidence might be the \$28.6 million included in Staff Cross Exhibit 10. However, Staff and ComEd agree that the \$28.6 million amount is not consistent with Section 16-108.5(c)(4)(D).

The Company's IB goes on at length to discuss pension accounting. (ComEd IB, pp. 85-86) As Staff set forth in its IB (Staff IB, p. 62) and Ms. Ebrey's testimony (Staff Ex. 1.0, p. 10; Staff Ex. 13.0, p.13), Staff at no point in the case took issue with the correct accounting for the Company's pension plans. Also, on page 86, the Company falsely claims that Staff witness Ebrey "changed course" in her rebuttal testimony. (ComEd IB, p. 86) Staff's position throughout the case has been that since the pension plan is not overfunded, no pension asset exists for ratemaking purposes and thus no investment return is appropriate under Section 16-108.5(c)(4)(D). The accounting for the pension plan does not dictate ratemaking treatment. It has not in the past (Staff Ex. 13.0, pp. 6-10) and it should not start now. Even Company witness Houtsma appears to agree with that concept as she states in surrebuttal that "the mere recording of the journal entries does not mean that rates should be impacted." (ComEd Ex. 21.0, p. 7, lines 149 – 152)

ComEd also discusses the Commission's Order on Rehearing in Docket No. 05-0597. (ComEd IB, p. 87) Throughout this case, ComEd has tried to make much of the fact that in the Commission's Order on Rehearing the Commission stated "the

Commission approves cost recovery of the Pension Asset under Alternative 3 that ComEd proposed on rehearing.” (ComEd IB, p. 87) However, ComEd’s IB, similar to ComEd’s witness Ms. Houtsma, fails to discuss the Commission’s Amendatory Order in Docket No. 07-0566. (*Tr.*, March 9, 2012, p. 986) In an Amendatory Order for Docket No. 07-0566, the Commission stated the following with regard to its Order in Docket 05-0597:

In accordance with our Order in Docket 05-0597, ComEd did not include the \$803 million pension contribution in rate base and instead, included an annual debt return on the pension contribution of 4.75%. In this proceeding, ComEd did not re-litigate the merits of including the pension contribution in rate base.

(Amendatory Order, November 3, 2008, Docket No. 07-0566, pp. 1-2)

As Staff argued in its IB, the Commission in its amendatory order in Docket No. 07-0566, rather than define the \$803 million as a pension asset as it did in the Order on Rehearing in Docket 05-0597, provided clarification that the recovery was not a return on a pension asset but rather a return on a pension contribution. There is a significant difference between a pension contribution and a pension asset, which Company witness Houtsma testified to during cross examination. (*Tr.*, March 13, 2012, p. 948). (Staff IB, p. 60)

Finally, at pages 88-89, ComEd makes a failed attempt to argue that Ms. Ebrey’s proposal in this docket, not ComEd’s, is a departure from prior Commission Findings. (ComEd IB, pp. 88-89) To support its argument ComEd presented a chart. The first column shows Docket Nos. 05-0597, 07-0566, 10-0467 and 11-0721. Across the top of the chart it lists information ComEd believes is relevant. Unfortunately, ComEd’s chart, like the rest of its brief on this pension issue, is misleading. ComEd’s chart leaves off two relevant columns. ComEd’s chart should have included a column entitled “Did the

Commission approve a Pre-Paid Pension Asset in Rate Base?” The boxes in that column would have indicated the following: 05-0597 - No, 07-0566 - No, 10-0467 - No, and 11-0721 - Unknown. (*Tr.*, March 9, 2012, pp. 457-460) The final column that should have been included in ComEd’s chart should have been “Was Staff witness Ebrey the Staff witness on the Pension Asset issue?” The boxes in that column would have indicated: 05-0597 – Yes, 07-0566 - No, 10-0467 - No, and 11-0721 - Yes. (*Tr.*, March 9, 2012, p. 460) A chart such as this would leave no doubt that the Commission has never approved a pre-paid pension asset as ComEd seeks in this proceeding and this is only the second time Ms. Ebrey has presented her position to the Commission for its consideration. As discussed earlier in this Reply Brief and Staff’s IB, the Commission should look at Ms. Ebrey’s approach in a whole new light given the new facts that an incentive for ComEd to fully fund its pension plan is not working and ComEd has never obligated itself to have its pension plan fully funded within a certain number of years. As a final note with regard to the chart on page 89 of ComEd’s IB, Staff would observe for the Commission and ALJs benefit that if the Commission decides to rely upon the customer benefit figures presented in ComEd’s chart, which it should not, the \$30.2 Million figure for Docket No. 07-0566 and the \$34.1 Million figure for Docket No. 10-0467 as far as Staff can tell are not in the evidentiary record of this proceeding nor do they appear in the final orders for those respective dockets. In addition, ComEd incorrectly indicates that the Pension Plan was underfunded in Docket No. 05-0597. In that proceeding, the \$803 million contribution that became the basis for the return was made specifically to fully fund the plan.

Based on the foregoing discussion, the Commission should reject the Company's arguments and approve Staff's adjustment to disallow a return on a pension asset as provided for under Section 16-108.5(c)(4)(D).

**b. Pension Expense**

The Company wrongly claims that Staff's proposal regarding pension expense is simply selective updating and should be rejected. (ComEd IB, p. 92) Staff's proposal balances the interests of the Company (through a return on excess pension contributions) with those of the ratepayers (through lowered interest expense resulting from those contributions). This balancing is consistent with what the Commission approved in Docket No. 05-0597. (Staff IB, p. 65) If the Commission does not accept Staff's proposed adjustment to the 2010 actuarial pension expense, the Commission should consider one of the alternatives Staff offered to use the 2011 or 2012 actuarial study as the basis for determining the actuarial pension expense which would be consistent with the statute. (*Id.*, p. 66)

**6. Income Taxes: Interest Synchronization**

**7. Other**

**VI. RATE OF RETURN**

**A. Overview, Including Overall Cost of Capital**

**B. Capital Structure**

**1. Year End/Average Year Capital Structure**

Staff's IB clearly explains why, contrary to ComEd's arguments, average capital structures: (1) qualify as actual capital structures (Staff IB, pp. 67-70); (2) more accurately measure the earned rate of return on equity for a calendar year than year-

end capital structures (Staff IB, pp. 70-71); and (3) are less sensitive to manipulation than year-end capital structures. (Staff IB, pp. 71-75)

Even if the Commission were required to authorize a capital structure based exclusively on FERC Form 1 data, which it is not,<sup>7</sup> it could still approve an average capital structure based on year-end balances, as provided in FERC Form 1. The Company's claim that "an average capital structure based on the FERC Form 1 is really an average of two end-of-year capital structures" and, therefore, is inappropriate (ComEd IB, pp. 95-96) is absurd given that the December 31, 2009 balances are identical to opening January 1, 2010 balances. As shown on ComEd Ex. 4.2 (WP 12), lines 1 and 2, the Company used the December 31, 2009 short-term debt balance in its monthly average net short-term calculation. This is the methodology set forth in 83 Ill. Adm. Code 285.4000(b), which states, "[e]ach monthly average shall equal the simple average of the beginning and ending monthly balances." (83 Ill. Adm. Code 285.4000(b)) Similarly, as the ComEd IB states former Section 16-111(e) of the Act required calculating an average return on equity as follows:

- (a) If the 2-year average of an electric utility's earned rate of return on common equity, calculated as its net income applicable to common stock divided by the average of its beginning and ending balances of common equity using data reported in the electric utility's Form 1 report to the Federal Energy Regulatory Commission. (ComEd IB, p. 96, citing 220 ILCS 5/16-111(e))

As ComEd recognizes, FERC Form 1 does not contain any balances that are explicitly labeled as "beginning." (*Tr.*, March 9, 2012, p. 533) Consequently, according to the language in the statute, the General Assembly obviously recognized that an end of year

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<sup>7</sup> Despite ComEd's argument to the contrary, the Company's proposed capital structure is not based on FERC Form 1 data. See Staff IB, pp. 69-70.

balance for the prior year is synonymous with the beginning balance for the current year.

ComEd asserts, "...the FERC Form 1 actually provides two year-end balances, and thus averaging those balances would result in a two-year average balance – 2009 and 2010 – as opposed to a 2010 average balance." (ComEd IB, p. 96) The Company's argument is absurd. Given there are 365 days between December 31, 2009 and December 31, 2010, using two year-end balances clearly results in a one-year average rather than a two-year average balance.

ComEd argues it is not interested in "manipulating its capital structure in a nefarious manner," but if it did attempt to do so, then it would be possible even with an average capital structure. (ComEd IB, p. 94) Notwithstanding the Company's reference to "nefarious manipulation," Staff avers that ComEd's Board of Directors could review and approve financial transactions that would benefit ComEd's shareholders, but which are not appropriate for ratemaking purposes; to be clear, such financial transactions do not have to be illegal in order to be improper for ratemaking purposes. (ComEd Cross Ex. 15) The Company also claims that ComEd's financial transactions require Commission approval. (ComEd IB, p. 95) Yet, Commission approval of financing transactions under Section 6-102 of the Act does not address the reasonableness of the timing of debt and equity financing transactions.<sup>8</sup> Further, the Commission must approve securities issuances that are subject to Section 6-102(d) of the Act regardless

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<sup>8</sup> For example, see Order in Docket No. 12-0059 (ComEd's application for financing authority pursuant to Section 6-102(d) of the Act, which authority was granted for a three year period ending February 27, 2015), February 23, 2012, pp. 8-9; Docket No. 10-0315 (ComEd's application for financing authority pursuant to Section 6-102(d) of the Act, which authority was granted for a three year period ending June 3, 2013), May 25, 2010, pp. 8-9; and Docket No. 10-0143 (ComEd's application for financing authority pursuant to Section 6-102 of the Act, which unused authority was extended from March 24, 2013 to March 28, 2015), March 21, 2012, p. 6.

of their merit and short-term financing, which is subject to Section 6-102(c) of the Act, can be issued without any Commission order whatsoever. (220 ILCS 5/6-102(c) and (d)) Therefore, Staff concludes that average capital structures are an important means to reduce the incentive to manipulate the timing of financing decisions by mitigating the effects of manipulation of the timing of financing decisions. (Staff IB, p. 75)

ComEd claims that Staff's recommendation to use an average capital structure for formula ratemaking does not comply with the directive in Section 16-108.5(c)(2) of the Act to use an actual capital structure. (ComEd IB, p. 93) ComEd argues, "[i]n instances when the Public Utilities Act has called for an average measurement of an earned return, it has done so explicitly, as evidenced by the former 220 ILCS 5/16-111(e)." (ComEd IB, pp. 95-96) By the same token, Staff notes that Section 16-108.5(c)(4)(D) of the Act specifies that the utility's end of year long term cost of debt shall be the investment return on "pension assets net of deferred tax benefits" authorized by the Commission. (Staff IB, p. 68) The language in Section 16-108.5(c)(4)(D) is clear that the measurement is done at year end ("investment return on pension assets net of deferred tax benefits equal to the utility's long-term debt cost of capital as of the end of the applicable calendar year." (220 ILCS 5/16-108.5(c)(4)(D) (emphasis added)) Whereas, in Section 16-108.5(c)(2) the words "as of the end" do not appear before "of the applicable calendar year" ("Reflect the utility's actual capital structure for the applicable calendar year, ..."). The former examples represent situations in which a statute has limited the discretion of the Commission with respect to appropriate measurement periods for ratemaking purposes. In contrast, the formula rate statute in Section 16-108.5(c)(2) does not specify the appropriate measurement

period for capital structure, which means such determination will be at the discretion of the Commission to define a “utility’s actual capital structure for the applicable calendar year.” Thus, Staff urges the Commission to adopt its recommendation to establish formula rates using an average capital structure.

Finally, ComEd asserts, “[i]t is noteworthy that use of an average capital structure in this case will increase costs to customers.” (ComEd IB, p. 96) This is a strange argument from ComEd given that the Company contests Staff’s proposed adjustments that would reduce costs to customers (e.g., cash working capital, reserve for accrued vacation, charitable contributions). (Staff IB, Appendix A) In any case, the argument is irrelevant. This proceeding not only sets rates for ComEd this year, but also will serve as a starting point for establishing formula rates for ComEd in the future. Thus, while it is true that an average capital structure increases rates for customers at first, it could reduce rates for customers in future years. In fact, one cannot predict whether an average capital structure will increase or reduce rates relative to ComEd’s end of year capital structure.<sup>9</sup> In summary, capital structure measurement is an issue that cannot be decided on the basis of effect on rates.

Therefore, for all the foregoing reasons, including those reasons set forth in Staff’s IB (Staff IB, pp. 66-75), the Commission should adopt Staff’s proposed average capital structure methodology for formula ratemaking proceedings.

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<sup>9</sup> ComEd’s capital structure proposal is actually a combination of an average short-term debt balance and end of year long-term debt and common equity balances. Nonetheless, Staff refers to ComEd’s proposed capital structure as “end of year” since long-term debt and common equity compose almost all of ComEd’s capitalization.

## **2. Long-term Debt and Equity Adjustment Regarding CWIP Accruing AFUDC**

The Commission's rules regarding the net short-term debt calculation, which both the Company's and Staff's capital structures employ, states, "[e]ach monthly short-term debt balance shall be reduced by an amount equal to the concurrent monthly balance of CWIP accruing AFUDC if the AFUDC rate is set in accordance with the Uniform System of the Accounts." (*Tr.*, March 9, 2012, pp. 504-505, citing 83 Ill. Adm. Code 285.4020)

ComEd recognizes that construction work in progress accruing an allowance for funds used during construction is assumed to be financed with short-term debt first; however, ComEd argues that there is no similar rule requiring the removal of long-term debt and equity. (ComEd IB, pp. 96-97) To the contrary, 83 Illinois Administrative Code 415.10 adopts the uniform system of accounts for electric utilities, including Electric Plant Instruction 3(17): Allowance for Funds Used During Construction, which provides the formula and elements for the computation of the allowance for funds used during construction. (83 Ill. Adm. Code 415.10) This formula assumes that short-term debt is the first, but not the only, source of funds used for construction work in progress. Specifically, the Commission has determined the following:

On a utility's financial statements, the total dollar value of assets must equal the total dollars of liabilities and owner's equity. In a rate case, however, the total dollars of jurisdictional rate base does not necessarily equal total capitalization. This is because, for example, utilities may purchase assets that are not entirely included in rate base since some assets may be used in multiple regulatory jurisdictions. As a result, for various reasons a utility's total capitalization and rate base may not be equal in amounts. Due to the fungible nature of capital, it is generally assumed that all assets, including assets in rate base, are financed in proportion to total capital. However, due to certain regulatory accounting practices, short-term debt requires special attention...

A utility's approved rate of return on rate base and the authorized AFUDC rate should be calculated in a coordinated manner to avoid either over or

under-recovery of the utility's financing costs. The Commission concurs with Staff that the formula for calculating the AFUDC rate assumes that CWIP is financed first with short-term debt and is then financed with the remaining sources of permanent capital in proportion to total permanent capital. The Commission finds that Staff's proposed two-part formula for calculating UE's short-term debt balance is consistent with the manner in which short-term debt is treated in calculating the AFUDC rate. This formula will include in the capital structure the portion of short-term debt that is used to finance the acquisition of assets included in rate base but not the portion assumed for ratemaking purposes to finance CWIP.

Finally, Staff correctly points out that the issue of how short-term debt balances should be reported for ratemaking purposes was recently established by Commission rule in Docket 02-0509. In that proceeding, the Commission adopted rules requiring utilities to report short-term debt balances using the same formula Staff used to calculate UE's balance of short-term debt in this proceeding. (Order, Docket Nos. 02-0798, 03-0008 & 03-0009 (Cons.), October 22, 2003, pp. 67-68)

Similarly, in Docket No. 08-0363, the Commission found Staff's AFUDC formula-based adjustments to the components to the capital structure, including long-term debt and common equity, reasonable and stated:

...the Commission finds that that the methodology employed by Staff to quantify the proportion of short-term debt that should be reflected in the capital structure is reasonable. The Commission believes that Staff's approach (which subtracts from projected monthly balances of short-term debt balances the balances of CWIP accruing AFUDC) reasonably estimates the proportion of short-term debt that Nicor uses to finance assets included in rate base...

Staff proposed to adjust all of the components of its recommended capital structure to reflect the Commission's methodology for calculating CWIP-accruing AFUDC. This assumes that short-term debt is the first source of funds for financing CWIP and that any CWIP that is not funded by short-term debt is funded proportionally by the remaining sources of capital...

While the parties are correct that from a practical standpoint cash is fungible, this is a ratemaking proceeding and to estimate Nicor's cost of capital as accurately as possible the Commission cannot ignore the ratemaking assumptions underlying the AFUDC formula. The AFUDC

formula includes assumptions regarding how CWIP is financed. It is clear to the Commission that the ratemaking assumptions regarding how CWIP is financed impacts, for ratemaking purposes, how rate base is financed. To ignore those assumptions in this proceeding would run the risk of misstating the proportion of long-term capital used to finance rate base, thereby overstating or understating the cost of capital applied to rate base. While it is not necessary that the total dollars of capital contained in the capital structure match the total dollars of rate base, in estimating the rate of return, it is important that the proportion of dollars used to finance rate base be estimated as accurately as possible. The Commission concludes that, in this instance, Staff is correct that the assumptions underlying the AFUDC formula impact the proportion of dollars remaining to finance rate base.

(Order, Docket No. 08-0363, 3/25/2012, pp. 49-51)

Staff Ex. 18.01 illustrates the double counting of dollars that Staff's construction work in progress adjustment avoids. The Company misses the point of Staff's exhibit when it argues, "[i]t is well settled that capital structure is a ratio or percentage that always equals 100%" and, thus, Staff's proposed CWIP adjustment must result in a capital structure comprising a lower percentage of long-term debt and equity than ComEd proposes. (ComEd IB, p. 98) In summary, the Company asserts that capital structure is a ratio that is applied to dollar values. (*Tr.*, March 9, 2012, p. 521) Yet, the Company's argument ignores the obvious: capital structure ratios are derived from dollars of capital. That is, even though capital structure can be represented in ratios (*Id.*, p. 522), double counting dollars of capital is the problem that arises when Staff's adjustment is made in the net short-term debt calculation but a corresponding adjustment is not made to the long-term capital components. In contrast, capital structure ratios are proportions that change based on dollar amounts of capital. (Staff Ex. 18.0, p. 18; *Tr.*, March 9, 2012, p. 532)

Nevertheless, the Company argues that deriving capital structure ratios from dollars "is not a proper way to determine capital structure." (ComEd IB, pp. 98-99) That

statement is unfathomable given that ComEd calculated its capital structure ratios using actual dollars, as shown on Company Schedule D-1 and Sch FR D-1. The Company also used dollars to calculate capital structure ratios during cross-examination. (*Tr.*, March 9, 2012, p. 539)

Thus, the Company errs when it asserts:

It is undisputed, however, that ComEd's total capital exceeds the sum of CWIP accruing AFUDC and rate base. Thus, Schedule 18.01, which purports to prove the contrary assumption [*i.e.*, ComEd's total capital equals the sum of ComEd's rate base and CWIP accruing AFUDC], is simply not applicable to ComEd.  
(ComEd IB, p. 98)

The only dollars that the Commission has jurisdiction over relate to the sum of dollars assigned to rate base and CWIP. Even if total capital exceeds the sum of those dollars, they are not pertinent with respect to the Commission's ratemaking jurisdiction. For example, FERC has jurisdiction over ComEd's dollars that support its transmission operations. As such, the only dollars the Commission must consider here are the dollars that support rate base and CWIP in connection with ComEd's retail electric delivery service operations. Moreover, the potential exists for double counting those Commission-jurisdiction dollars unless the Commission adopts the adjustment Staff proposes for removing remaining CWIP accruing AFUDC.

As noted in the Commission's Order for Docket No. 95-0076 (Illinois-American Water Co. proposed general increase in water rates, December 20, 1995, pp. 50-51), which states:

Staff notes that in the Illinois Power case, the Commission reached the following conclusion:

The Commission concludes that short-term debt should not be included in IP's capital structure. Since the AFUDC rate is calculated on the

assumption that all short-term debt is used to support CWIP not in rate base, placing it in the capital structure for the purpose of determining the rate of return to apply to rate base would constitute double counting. (Order, Docket Nos. 84-0055, 87-0695 and 88-0256 (Consol.), March 30, 1989, pp. 189-190).

Given the Commission's decision in Docket No. 95-0076, either ComEd is wrong when it claims that removing from the ratemaking capital structure long-term capital that has been assigned to CWIP accruing AFUDC is unnecessary to avoid double counting that capital, or the Commission was wrong to conclude that the same AFUDC formula would result in double counting if short-term debt that has been assigned to CWIP accruing AFUDC is not removed from the ratemaking capital structure.

The Company's argument that if the Commission accepts Staff's CWIP adjustment, then it must also remove \$547 million of long-term debt equal to the pension contributions (which ComEd refers to as a "net pension asset") must be rejected because it is based on a false premise. (ComEd IB, p. 99) The Company's argument implies that excess pension contributions were funded with long-term debt because the Act limits the return on any "net pension asset" to the cost of long-term debt. (220 ILCS 5/16-108.5(c)(4)(D)) To the contrary, the Company testified that the sources for special contributions were both internally generated funds and debt. (*Tr.*, March 12, 2012, pp. 905-906) Putting aside Staff's position that the Company does not have a pension asset, Staff avers further that by limiting the return on any "net pension asset" to the cost of long-term debt, the statute does not assume that long-term debt funds excess pension contributions. Rather, the statute recognizes, as the Commission has in past ratemaking proceedings, that excess pension contributions do not generate sufficient benefits to ratepayers that justify a higher return. (See Staff IB, pp. 59 and 63-

64) In other words, allowing the “net pension asset” a rate of return on debt rather than the rate of return on capital constitutes a prudence and reasonableness adjustment.

Finally, although the Company asserts that Staff’s remaining CWIP adjustment adds “great complexity to the formula rate equation” (ComEd IB, p. 99), Staff Schedule 7.03 clearly shows how to calculate the remaining CWIP adjustment in future formula rate proceedings. Similarly, Staff’s proposed changes to the Company’s Sch. FR D-1 would incorporate adjusted balances of debt and equity into the capital structure calculation. Nevertheless, as Staff explained, if simplicity were the main objective then a better alternative would be to calculate gross short-term debt, which does not remove remaining CWIP accruing AFUDC from the short-term debt balance, and thereby render similar adjustments to debt and equity unnecessary. (Staff IB, p. 78)

For all the foregoing reasons, including those reasons set forth in Staff’s IB (Staff IB, pp.75-80), the Commission should adopt Staff’s proposed adjustment for formula ratemaking proceedings.

### **3. Equity Adjustment Regarding ComEd of Indiana**

ComEd errs when it asserts “it is undisputed that ComEd of Indiana is not an “unregulated or nonutility company” and Staff’s “adjustment is also unprecedented.” (ComEd IB, pp. 100-101) To the contrary, the Commission has determined that “ComEd Indiana is a public utility in Indiana, but is not a ‘public utility’ as defined in Section 3-105 of the Act.” (Order, Docket No. 03-0449, September 22, 2003, p. 2) Utilities not meeting the definition of public utility as set forth in Section 3-105 of the Act are non-utility and unregulated affiliates for the purpose of Section 9-230 of the Act. In Docket Nos. 07-0585 et al. (Cons.), the Commission removed from AmerenCIPS’ cost

of capital the incremental cost incurred by AmerenCIPS (a public utility, as defined by the Act) resulting from that company's decision to refinance an intercompany note held by its affiliate AmerenUE (a Missouri utility) pursuant to Section 9-230 of the Act. The Commission's Order states:

[t]he Commission notes that Staff is rightly concerned about the possibility of cross-affiliate subsidization and the possibility that AmerenCIPS' ratepayers are providing a windfall to AmerenUE by the redemption at issue here...The Commission finds that while there may be some collateral benefits to AmerenCIPS' ratepayers, it appears that there is an increased cost due to this transaction, and pursuant to 9-230 of the Act, it would be improper to reflect any resulting incremental cost increase in AmerenCIPS' cost of capital, regardless of any potential benefits relating to repayment flexibility that AmerenCIPS may realize due to refinancing the intercompany note with bonds.

(Order, Docket Nos. 07-0585 et al., 9/24/2008, p. 178)

Staff's position is that, under Section 9-230, the question is whether an entity is regulated by the Illinois Commerce Commission *or* whether the entity is an Illinois utility. It is undisputed that Commonwealth Edison of Indiana meets neither requirement. ComEd of Indiana is not regulated by this Commission, and this Commission has recognized that it is not a public utility as defined by Section 3-105 of the Act. (Order, Docket No. 03-0449, September 22, 2003, pp. 1-2) Under ComEd's interpretation of the statute, ComEd's affiliation with PECO, Ameren Illinois Company's affiliation with Ameren Missouri, or Peoples Gas'/North Shore Gas' affiliation with Integrys' Michigan Gas Utilities would allow their risks to be included in determining rates.

Section 9-230 of the Act precludes *any* increased risk of cost of capital caused by an affiliation from being passed on to rate payers. This section employs clear mandatory language removing all discretion from the Commission on this issue. Section 9-230 provides that:

In determining a reasonable rate of return upon investment for any public utility in any proceeding to establish rates or charges, the Commission *shall not* include *any* (i) incremental risk, (ii) increased cost of capital, or (iii) after May 31, 2003, revenue or expense attributed to telephone directory operations, which is the direct or indirect result of the public utility's affiliation with unregulated or nonutility companies.  
220 ILCS 5/9-230 (emphasis added).

Illinois courts have also interpreted Section 9-230 to mean that:

... if a utility's exposure to risk is one iota greater, or it pays one dollar more for capital because of its affiliation with an unregulated or nonutility company, the Commission must take steps to ensure that such increases do not enter in its ROR calculation.

(*Illinois Bell Tel. Co. v. Illinois Commerce Comm'n*, 283 Ill. App. 3d 188, 207 (2<sup>nd</sup> Dist. 1996)(“*IBT*”))

Moreover, companies are incited to use a capital structure with an excessive amount of equity, which would then allow ComEd a greater return on its capital, while leaving ratepayers to shoulder the costs. The court in *CUB* succinctly explained that:

When a larger corporation owns a utility, the corporation is generally motivated not to establish an optimal, lowest cost capital structure for the utility, but to use instead a structure with a greater percentage of equity than is optimal, thereby allowing the corporation to realize a greater return. The assured profits from the regulated utility can then bolster the security of the corporation, allowing it to sell its own debt instruments at lower cost and use the debt capital to finance riskier, unregulated and competitive ventures. Thus, the corporation maintains an overall capital structure with a higher proportion of low-cost debt, while reporting the capital structure of the owned utility with a higher proportion of high-cost equity.

(*Citizens Utility Board v. Illinois Commerce Comm'n*, 276 Ill. App. 3d 730, 745 (1st Dist. 1995))

The Company's proposed capital structure, which includes ComEd of Indiana, clearly reflects these incentives (harmful to the ratepayer but beneficial to ComEd's shareholders). Staff's recommendation does not.

ComEd also argues:

...Ms. Phipps' assertion that ComEd of Indiana is financed with 100% equity is factually incorrect. ComEd finances all assets with a mixture of debt and equity... Thus, if the Commission agrees with Ms. Phipps' proposal to remove ComEd of Indiana from ComEd's capital structure, it should do so not at 100% equity, but at the proportional amounts of debt and equity that are reflected in ComEd's overall capital structure (excluding goodwill).  
(ComEd Ex. 23.0, lines 217-223 and 232-235)

To the contrary, ComEd of Indiana finances its operations entirely with equity. That is, ComEd of Indiana has no outstanding indebtedness. (ComEd Exs. 15.1 and 23.1, p. 2) As to the manner in which ComEd originally funded its investment in ComEd of Indiana, this is irrelevant because the source of an investor's funds is distinguishable from the investment made with those funds. For example, even though Exelon Corp. issued \$1.7 billion dollars of long-term debt to fund pension contributions in June 2005 for its subsidiaries, including ComEd, those proceeds were recorded as equity on ComEd's balance sheet. (Tr., March 9, 2012, pp. 480-483, citing Staff Cross exhibit 3, p. 80; Tr., March 12, 2012, pp. 903-906)

To support the irrelevant argument that "ComEd finances all assets with a mixture of debt and equity," ComEd cites *Central Ill. Public Serv. v. Ill. Commerce Comm'n*, 243 Ill. Ap. 3d 421, 443 (4<sup>th</sup> Dist. 1993). ComEd notes that "CIPS provided testimony that its capital structure represents a pool of invested capital which supports its overall investment in electric, gas and nonutility operations, and that one cannot trace capital from its source to its use" and attempt to remove temporary case investments from capital structure pursuant to Section 9-230 was properly rejected. (ComEd IB, p. 101) ComEd's reliance on *Central Ill.* is misplaced. In *Central Ill.*, the court rejected a 9-230 challenge because temporary cash investments could be used to

purchase a utility plant. In the case of the investment in ComEd of Indiana, it is clear that that investment is not ComEd utility plant and could not be used to purchase utility plant. (*Central Ill. Public Serv. v. Ill. Commerce Comm'n*, 243 Ill. App.3d 421, 443 (4th Dist. 1993))

ComEd opposes Staff's removal of ComEd of Indiana and argues that this adjustment is unprecedented and ComEd of Indiana does not increase ComEd's equity percentage. (ComEd IB, pp. 100-101) Although the record in this proceeding does not address why ComEd's investment in ComEd of Indiana was not removed from ComEd's capital structure in previous rate cases, it is not difficult to arrive at a plausible explanation – that ComEd's investment in ComEd of Indiana was not large enough to affect ComEd's capital structure ratios in previous rate cases just as ComEd of Indiana is not large enough to effect ComEd's capital structure ratios in this rate case. In fact, if the scope of this proceeding was limited to determining a single revenue requirement only, Staff would probably not have proposed this adjustment given the effect is immaterial. However, this is not a traditional rate proceeding. In this case, the Commission will establish a methodology for future formula rate cases, and there is no guarantee that ComEd's investment in the subsidiary will not have greater effect in future formula rate proceedings. As such, the methodology for calculating ComEd's equity balance in future cases should remove the effects of ComEd Indiana as required by Section 9-230 of the Act. (Staff IB, p. 81)

Finally, ComEd misrepresents Staff's position when it argues, "Ms. Phipps claims that ComEd of Indiana increases ComEd's equity percentage, thereby increasing ComEd's cost of capital." (ComEd IB, p. 100) To be clear, Staff testified that ComEd's

investment in ComEd of Indiana increases ComEd's balance of common equity (in dollars). (Staff IB, p. 80, emphasis added)

For all the foregoing reasons, including those reasons set forth in Staff's IB (Staff IB, pp. 80-81), the Commission should adopt Staff's proposed methodology for calculating ComEd's common equity balance, which removes goodwill and ComEd's investment in non-utility and unregulated affiliates, for formula ratemaking proceedings.

#### **4. Common Equity Ratio/Cap Limit**

IIEC argues that the Commission should order that the formula rate reflect a common equity ratio limit of 55% "to ensure that ComEd's overall cost of capital reflects reasonable and prudent management of its capital structure." (IIEC IB, p. 36) Staff notes that the Company's current capital structure has received a credit upgrade just since testimony was filed in this docket and could improve more. (Staff IB, p. 82) This new regulatory environment in Illinois reduces utility risk; therefore, a cap this high is inappropriate. As Staff has articulated in its IB, the appropriate capital structure for ComEd under Section 16-108.5 of the Act should be studied in the report Staff has recommended and determined for the Company's 2013 formula rate filing.

#### **5. Subsequent Procedure/Process Re: Capital Structure Issues**

ComEd asserts that it is unnecessary for the Commission to order the Company to work with Staff on evaluating more leveraged capital structures since ComEd has stated its willingness to work with Staff voluntarily. (ComEd IB, pp. 102-103) Staff notes that ComEd's willingness to participate in voluntary meetings with Staff is welcome but insufficient. As Staff recommended, the Commission should order the Company to work with Staff and to submit a report to the Commission with its 2013 formula rate

filing. (Staff IB, p. 82) Without an order, the Company would not have to serve the Commission with a report and could end discussions with Staff at any time. Further, a report would provide the Commission information to assess the effect of the Illinois formula rate law on ComEd's operating risk and would assist the Commission in determining if ComEd's capital structure is prudent and reasonable in the context of that level of operating risk. A report to the Commission should include, but not be limited to: 1) credit rating agency reports describing the impact of the Illinois formula rate law on Illinois utilities; 2) ComEd's capital structure ratios for each year from 2010 to 2012 (calculated in accordance with the rating agencies' methodologies and Illinois law and regulatory practice); and 3) the most recent two years of Moody's reports that provide its factor analysis (including ratios) ratings for ComEd.

IIEC states that: "there should be a separate analysis or study done by the Commission, in the context of a formal – not informal – proceeding, to determine an appropriate common equity ratio cap for ComEd on a going-forward basis." (IIEC IB, p. 37) Staff stands by its recommendation that the report be litigated in the 2013 formula rate filing by the Company. The formal proceeding that IIEC recommends where "an appropriate capital structure is determined" would be in *that* docket. The report Staff seeks would be a filing *by the Company*, reflecting its position. While Staff, and other parties, should they be interested, would certainly have input into the report, it would be an informal process to inform ComEd about the parties' opinions on an appropriate capital structure. Staff would encourage all interested parties to participate in the informal process.

**6. Other**

**C. Cost of Capital Components**

**1. Cost of Short-Term Debt**

**2. Cost of Credit Facilities**

Staff described its methodology for the Section 9-230 adjustment to ComEd's credit facility fees (or bank facility fees). ComEd has not explained how ComEd's affiliate, ExGen, was assigned fees that were only 25% of the total fees assigned to ComEd, PECO and ExGen by JPMorgan and Seaway even though ExGen's credit facility was 32% of the aggregate credit facilities for those three entities.<sup>10</sup> (Staff IB, pp. 85-87; *Tr.*, March 9, 2012, p. 478) Therefore, for ratemaking purposes, Staff had to reduce ratably the amount of credit facility fees assigned to ComEd based on the amount of ComEd's credit facility relative to the aggregate amount of the three credit facilities that Exelon Corp. subsidiaries entered into during 2010. (Staff IB, pp. 83-84)

ComEd continues to argue: (1) Section 9-230 does not apply to ExGen and PECO; (2) bank fees should be "fully recoverable" unless the Commission finds that those fees were unreasonable or imprudent; and (3) Staff's adjustment is contrary to well-settled ratemaking principles. (ComEd IB, pp. 103-104)

As stated above, Section 9-230 applies to affiliates that do not fit the definition of Section 3-105 of the Act.

The adjustment to credit facility fees is not a matter of reasonableness or prudence. Illinois courts have specifically addressed this issue regarding the interpretation of Section 9-230 of the Act. The court in *Illinois Bell Telephone Co. v.*

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<sup>10</sup> In other words, ComEd never explained why ExGen got a better rate on credit facility fees than ComEd.

*Illinois Commerce Comm’n*, 283 Ill. App. 3d 188, 207, 218 Ill. Dec. 598, 669 N.E.2d. 919 (1996), held that “In section 9-230, the legislature used the word “any” to modify its prohibition of considering incremental risk or increased cost of capital in determining a reasonable rate of return (“ROR”). This usage removes all discretion from the Commission. Section 9-230 does not allow the Commission to consider what portion of a utility’s increased risk or cost of capital caused by affiliation is “reasonable” and therefore should be born by the utility’s ratepayers; the legislature has determined that any increase whatsoever must be excluded from the ROR determination. *It is impermissible for the Commission to substitute its reasonableness standard for the legislature’s absolute standard.*” (emphasis added) As succinctly put by the Court, it is not permissible for the Commission to substitute its reasonableness standard for the legislature’s absolute standard. Therefore, ComEd’s arguments that the credit facility fees were reasonable and prudent are irrelevant to its recovery of these fees. As a matter of law, the Commission must adopt Staff’s recommendation to adjust the amount of ComEd’s credit facility fees.

Finally, the Company argues Staff’s “attempt to substitute a percentage based on allocation when direct assignment is available is contrary to well-settled ratemaking principles and should be rejected.” (ComEd IB, p. 104) Staff contends that those principles would not apply to Section 9-230 where the Act has established the standard and the appellate court has clearly defined the threshold utilities must meet in ratemaking proceedings. That is, Section 9-230 of the Act supersedes any “ratemaking principles” to which ComEd refers. Towards that end, ComEd has not proposed an adjustment to address the Section 9-230 requirement.

For all the foregoing reasons, including those reasons set forth in Staff's IB (Staff IB, pp. 83-87), the Commission should adopt Staff's proposed adjustment to ComEd's credit facility fees, which removes the incremental cost resulting from ComEd's affiliation with non-utility and unregulated companies, for formula ratemaking proceedings.

### **3. Cost of Long-Term Debt**

The Commission should adopt Staff's recommendation to use an average embedded cost of long-term debt for formula ratemaking proceedings for all the reasons set forth in this reply brief (see discussion under VI.B.1.) and Staff's IB (see Staff IB, pp. 67-75 and 87).

### **4. Cost of Common Equity**

## **VII. COST OF SERVICE AND RATE DESIGN**

The Company's IB offers insufficient support for the Company's positions on cost of service and rate design issues. Regarding the issue of when studies should be presented by the Company for consideration by the Commission, the Company relies on a few unsupported assertions to justify its position. (ComEd IB, pp. 105-106) With regard to the calculation of customer and delivery charges for residential and Watt Hour customers, the Company reprises a set of arguments that have been thoroughly refuted by Staff during the course of this proceeding. (*Id.*, pp. 107-108) The weakness of ComEd's arguments further confirms that the Company's proposals on these issues are deficient and deserve to be rejected by the Commission.

**A. Studies Submitted Pursuant to 2010 Rate Case Order**

ComEd makes a weak case for rejecting Staff's proposal concerning how the Commission directives from Docket No. 10-0467 should be discussed in its Order for this case. The Company begins by noting Staff's recommendation "that ComEd be ordered to integrate the studies into the cost of service study to be submitted for the revenue neutral cost of service and rate design proceeding." (ComEd IB, pp. 105-106) However, the Company again opposes the recommendation based on the claim that "[t]he Commission *did not* order ComEd to propose those studies as ComEd's position." (ComEd IB, p. 106) ComEd goes on to reemphasize that "ComEd simply was not required to adopt any one position." (*Id.*) For these reasons, the Company recommends that the Commission should reject Staff's proposal on this issue. (*Id.*)

The Company's arguments assume that these are voluntary directives from the 10-0467 Order that the Company may adopt at its discretion. That is an erroneous claim. For example, the Commission stated as follows in its 10-0467 Order about the use of direct observation:

ComEd shall work with Staff on this issue to develop a scientifically-significant representative of its direct observations on this issue. It shall also have this representation in its cost of service study/studies in its next rate case. This analysis shall be part of any initial rate case filing that ComEd makes.

(Order, Docket No. 10-0467, May 24, 2011, pp. 180-181)

This is a clear statement by the Commission requiring ComEd to revise its cost of service study to more appropriately incorporate the results of direct observations.

The Commission further required the Company to improve the sampling methods it used to distinguish primary and secondary costs and to factor "its analysis of these other utilities into its analysis of its primary and secondary costs." (Order, Docket No.

10-0467, May 24, 2011, p. 185). These directives clearly demand changes in the Company's cost of service approach and should not be considered optional as the Company suggests. (Staff Ex. 20.0, p. 5)

In sum, the Commission's directives in its 10-0467 Order clearly require revisions to the cost of service studies sponsored by ComEd and the appropriate venue for the Company to present those changes is in the upcoming revenue neutral cost of service and rate design cases required by Section 16-108.5(e) of the Act. Thus, the Commission should adopt Staff's recommendation and state in its Final Order for this case whether it wants the Company to provide the requisite studies and analyses in its initial filing for that upcoming proceeding. (Staff Ex. 20.0, pp. 5-6)

## **B. Rate Design, Including Upcoming Docket**

### **Residential and Watt Hour Charges**

The Company's efforts to defend its proposed Residential and Watt Hour charges are unpersuasive and should be rejected by the Commission.

ComEd begins its discussion by pointing out that "ComEd's compliance rates were fully and timely filed following the *ComEd 2010* Order." The Company further notes that Staff reviewed those rates and "informed ComEd that the rates were compliant with that Order." (ComEd IB, p. 107)

These statements are true, but irrelevant. It is correct that Staff made an error during its review of the compliance tariffs filed in response to the 10-0467 Order. However, the Company committed the same error by filing those incorrect rates in the first place. The difference now is that Staff wants to correct the error while the Company seeks to perpetuate it. (Staff Ex. 20.0, p. 7)

The Company further contends that its proposed rate design in this case is supported by record evidence. ComEd's first set of arguments note that the proposed rates are consistent with the rates "submitted in response to the ALJs' request for charges that would comply with the proposed order in ComEd's 2010 rate case" and that they are consistent with the compliance rates for that case. (ComEd IB, p. 108)

This "evidence" simply repeats ComEd's oft-stated contention that its proposals are consistent with its compliance rate design that it filed for Docket No. 10-0467. That is undisputed. What Staff does dispute is whether those compliance rates that ComEd filed are consistent with the 10-0467 Order, and the evidence presented in this case demonstrates that they are not.

Only at the end of its discussion does the Company even address the issue of whether its proposed rates are, in fact, consistent with the 10-0467 Order. ComEd focuses its attention on Staff's proposal. The Company seeks to denigrate Staff's argument for recovering 50% of fixed costs through fixed charges by arguing it "is based on a single sentence of the *ComEd 2010* Order, which is not placed in context, is read inconsistently with the Order's approval of a design that moves away from recovery of fixed costs through volumetric charges, and ascribes an incorrect meaning to that sentence standing alone." (ComEd IB, p. 107) According to ComEd, "[t]he quote says nothing at all about what percentage of variable or total costs can be recovered through those charges." (ComEd IB, pp. 107-108) The Company seeks to further undermine the Staff proposal by pointing out that Staff considers it "irrelevant" if its proposal should increase certain volumetric charges. (ComEd IB, p. 108) In the Company's view "the whole point of moving toward an SFV rate design is to reduce the reliance on volumetric

charges in recovering the costs of electric distribution, which are overwhelmingly fixed.”  
(ComEd IB, p. 108)

The most noteworthy aspect of the Company’s argument is the dearth of justification or support it provides for its proposed method of designing Residential and Watt Hour charges. The Company does not present a single argument or fact to show that the Commission directed the Company to set fixed charges to recover 50% of total costs as it proposes in this case. The reason for this shortcoming in ComEd’s argument is self-evident. The 10-0467 Order provides no support for the Company’s proposed rate design. ComEd witness Dr. Hemphill acknowledged this shortcoming under cross-examination by admitting he could find no place in the 10-0467 Order where the Commission states that either fixed charges or variable charges should be set to recover 50% of total costs. (*Tr.*, March 12, 2012, p. 83) However, Dr. Hemphill need look no further than at ComEd’s own Application for Rehearing in Docket No. 10-0467 which states “The Order errs in concluding that SFV should only apply to 50% of fixed delivery costs...” (ComEd Application on Rehearing, Docket No. 10-0467, June 23, 2011, p. 28) Clearly, that was ComEd’s own interpretation of the 10-0467 Order.

What the order does say about the setting of charges for Residential and Watt Hour customer is as follows:

In an effort to gradually move towards more realistic cost causation and to avoid rate shock, the Commission concludes that the use of volumetric charges be reduced so that they recover 50% of fixed delivery service costs.  
(Order, Docket No. 10-0477, May 24, 2011, p. 232.)

Since rates for these customers consist of volumetric and fixed customer and meter charges, setting volumetric charges to recover 50% of fixed delivery costs means that

fixed customer and meter charges should recover the remaining 50% of fixed delivery costs. (Staff Ex. 9.0, p. 9)

The choice in this proceeding is clear. Staff presents a rate design proposal that is consistent with the conclusions of the Commission's 10-0467 Order while the Company cannot point to any justification in the Order for its specific rate design proposal in this proceeding. Under these circumstances, the only reasonable conclusion for the Commission is to accept Staff's proposed Residential and Watt Hour rate design.

**C. Embedded Cost of Service Study, Including Distribution Losses**

**VIII. ADDITIONAL FORMULA / TARIFF ISSUES**

**A. Tariff Issues**

- 1. Separate Statement of Earnings Collar Effect**
- 2. Calculation of Increases for Three-Year Report**
- 3. Other**

**B. Ratemaking Process and Filing Issues**

- 1. Access to Information re Formula Rate Filing**
- 2. Triggers for Hearing on Certain Operating Costs**
- 3. Performance Condition for Incentive Compensation Costs**
- 4. Other**

**C. Reconciliation**

- 1. Average Rate Base Proposals (see also III.C.1)**

Staff affirms its recommendation that the Commission adopt the Intervenor and Staff proposals to use average rate base in determining the actual revenue requirement

for a calendar year in the annual reconciliation as provided for in subsections 16-108.5(c)(6) and 16-108.5(d)(1) of the Act. (Staff IB, pp. 99-103)

The Company's IB mischaracterizes subsection 16-108.5(d)(1) of the Act, claiming that this section of the statute provides that the reconciliation be calculated "consistently" with the initially established revenue requirement, implying that the revenue requirement reflected in rates and the revenue reconciliation revenue requirement must be calculated in exactly the same fashion. (ComEd IB, p. 115) ComEd essentially inserts the word "consistently" into the statute where it does not exist. The Act does not include any such provision. In fact, subsection 16-108.5(d)(1) concludes, specifically stating:

Notwithstanding anything that may be to the contrary, the intent of the reconciliation is to ultimately reconcile the revenue requirement reflected in rates for each calendar year, beginning with the calendar year in which the utility files its performance-based formula rate tariff pursuant to subsection (c) of this Section, with what the revenue requirement would have been had the actual cost information for the applicable calendar year been available at the filing date.  
(220 ILCS 5/13-108.5(d)(1), emphasis added)

Nowhere in this subsection does the Act provide for a reconciliation revenue requirement that is calculated consistently with the revenue requirement reflected in rates. Rather, the Act provides that the revenue requirement reflected in rates be reconciled to "what the revenue requirement would have been had the actual cost information for the applicable calendar year been available at the filing date." (*Id.*) Measurement of what the revenue requirement would have been had the actual cost information been available requires the use of average rate base, as average rate base is more representative of the actual plant balances in service throughout the year, and

more closely matches actual costs incurred during the year to the actual plant in service during the year. (Staff IB, p. 102)

The Company in its IB also attempts to fallaciously skew the Staff and Intervenor's positions on average rate base, stating that the reconciliation revenue requirement should not be calculated on an average using the FERC Form 1 data from the most recent calendar year and the year before that year. (ComEd IB, pp. 114-115, points (1) and (2)) In fact, Staff and the Intervenor's never propose calculating the reconciliation revenue requirement using data from any FERC Form 1 other than the FERC Form 1 from the most recent calendar year. Information required to calculate average rate base is included in the most recent FERC Form 1, because that document includes both beginning and end of year balances. (Staff IB, p. 102)

Further, the Company argues that it is proper to use averages in determining the formula rate revenue requirements only where the Act specifically calls for averages, because "the General Assembly knew how to say "average" in the Act when they meant "average"." (ComEd IB, pp. 115-116) Staff notes, however, that the Company contradicts its own argument. Even though the Act does not specifically instruct the use of averages in determining the appropriate amounts to be considered in the revenue requirements for customer deposits and for materials and supplies inventory, the Company itself proposes using averages in determining those amounts. (ComEd Ex. 22.2, Sch FR B-1, Ln. 39 & 46; App 1, Ln. 62; App 2 Ln. 1; WP 2; WP 14) Thus, the Company itself does not limit the use of averages in determining the formula rate revenue requirement to only those instances where the Act specifically calls for the use of averages, but also in those instances where the Company deems averages

appropriate. Staff argues that it is appropriate to use average rate base in determining the reconciliation revenue requirement as well.

Contrary to the Company's claims (ComEd IB, p. 116), the Company's proposed use of year-end rate base in calculating the reconciliation revenue requirement is not consistent with traditional ratemaking principles. It is well-established in the record that under traditional ratemaking principles, year-end rate base is utilized in setting forward-looking rates, as the year-end rate base is more representative of the future periods in which those rates will be effective. (Staff IB, p. 103) In fact, the Company's own IB alludes to this fact, stating regarding the formula rates set using the forecast revenue requirement:

Both Article IX historic test year cases and this formula rate case share a single critical attribute: rates will become effective after the costs have been incurred. And because an end of year rate base was deemed proper in the former, it is equally proper here.  
(ComEd IB, p. 26)

However, the reconciliation revenue requirement is far from forward-looking, and its goal is not to set rates effective after costs have been incurred. The goal of the reconciliation revenue requirement is very different – to determine the actual revenue requirement for the preceding calendar year.

Average plant in service is the more accurate and therefore superior measurement of plant in this instance, as it reflects a reasonable determination of the balance of increasing plant in service from the beginning of the year through the end of the year. As such, average rate base is more appropriate for use in calculating the reconciliation revenue requirement. (Staff IB, p. 103) Average rate base is more representative of the actual plant balances in service throughout the year, and more

closely matches actual costs incurred during the year (e.g., depreciation expense) to the actual plant in service during the year. (*Id.*, pp. 7-8) The Commission itself has previously acknowledged this fact, stating:

The average rate base proposed by Staff more accurately reflects the cost of service for the test year because it better matches the level of rate base during the test year with the revenues and expenses during the test year. (Order, Docket No. 04-0779, September 20, 2005, p. 8)

Further, an average rate base more closely matches actual capital investment in plant and associated return requirements during the year to the other expenses being incurred during the year. (Staff IB, p. 8)

The Commission should remain consistent with its previous conclusion regarding average rate base, and accept the Intervenor and Staff proposals to require the reconciliation revenue requirement be calculated using average rate base.

## **2. Interest Rate Proposals**

As explained in Staff's IB, financing revenue shortfalls is a separate issue from determining the appropriate interest rate for reconciliation amounts, which warrant a lower rate of return than the rate of return on rate base because investors will perceive the regulatory asset as less risky than traditional rate base assets. (Staff IB, pp. 104-107)

In Docket No. 10-0138 (ComEd's purchase of receivables and consolidated billing proceeding - "PORCB"), the Commission distinguished between the risk of assets and the manner in which those assets are financed and recognized that reconciliation amounts are essentially regulatory assets that warrant a lower rate of return than traditional rate base assets. More specifically, the Commission concurred with Staff's argument that statutorily-mandated reconciliations, which would "allow ComEd to

recover in a timely manner its actual costs, no more and no less” (see ComEd IB, p. 118), are analogous to transitional funding instruments in many respects. (See Order, Docket No. 10-0138, December 15, 2010, pp. 47-51)

ComEd asserts that transitional funding instruments “must be supported by numerous legal and procedural elements for which the current legislation does not provide.” (ComEd IB, p. 119) Yet, ComEd does not identify any of those legal or procedural elements to which it refers. Regardless, legal elements relating to transitional funding instruments simply isolated the default risk of the regulatory asset so that the interest rate for transitional funding instruments would reflect the risk of the regulatory asset alone rather than the risk of all ComEd’s assets. (Order, Docket No. 10-0138, December 15, 2010, pp. 41-44)

ComEd argues that it is not an AAA-rated company and, therefore, AAA bonds are an inappropriate benchmark for the interest rate for reconciliation amounts. (ComEd IB, p. 120) The Commission should reject the Company’s straw man argument. As ComEd acknowledges, Staff’s recommendation does not assume ComEd will separately finance reconciliation revenues. (Staff IB, pp. 104-105; ComEd IB, p. 119)

Importantly, the Company did not deny that the interest rate for transitional funding instruments reflected the risk inherent in the aggregate ability of ComEd’s customers to pay. (Staff IB, pp. 105-106) ComEd agrees that, in essence, a bank deposit by ComEd is a loan to a bank. As such, when ComEd deposits money in a bank the interest rate on those deposits is not based on ComEd’s credit rating. (*Tr.*, March 9, 2012, pp. 479-480) Nevertheless, ComEd’s proposal to require customers to

pay an interest rate that equals the rate of return on rate base would require customers to pay an interest rate on the amount of revenue shortfalls that that reflects ComEd's creditworthiness rather than the aggregate ability of ComEd's customers to pay.

The Company alleges that, "if the perceived benefit of this regulatory asset cannot be carved out of the overall cost of capital as updated annually, which is not practical, then it would be a double-count to also separately apply that perceived benefit in the reconciliation adjustment interest rate." (ComEd IB, p. 119) Foremost, there is no way to determine how this regulatory asset could be carved out of the overall cost of capital – *i.e.*, would ComEd "carve out" debt or equity? Staff notes that it would be imprudent for ComEd to finance a lower risk regulatory asset with higher cost debt, which suggests any carve out would have to be equity. In any event, the Company admits that there was no reconciliation asset in 2010. (*Tr.*, March 12, 2012, p. 903) As such, the Commission should reject the Company's baseless argument regarding a "double-count."

ComEd also alleges that any "perceived lower risk will be reflected in the cost of new securities issued in future calendar years and will automatically be reflected in ComEd's overall cost of capital each year, as the formula is updated for actual data." (ComEd IB, p. 119) This claim is incorrect. First, the return on equity is determined pursuant to a formula in the statute that equals U.S. Treasury yields, plus 580 basis points. (*Tr.*, March 13, 2012, pp. 901-902) Therefore, the return on equity will not reflect lower risk regulatory assets that result from reconciliations because it is based on a formula that does not include any risk adjustment. Second, contrary to ComEd's claim that investors' perceptions of lower risk would be reflected in the cost of new debt

securities, ComEd's formula rate includes an embedded cost of long-term debt with maturities extending out as far as 2038. (*Tr.*, March 13, 2012, p. 902; Schedule 18.02, p. 1) Importantly, assets with different lives have different required rate of return as evidenced by 30-year U.S. Treasury bonds having yields that exceed 10-year U.S. Treasury bonds by 91 basis points. (Order, Docket No. 10-0138, December 15, 2012, p. 39) Given the term to maturity for ComEd's currently outstanding indebtedness far exceeds the time horizon for annual reconciliations required by the formula rate law, the likelihood of ComEd's embedded cost of long-term debt reflecting the lower risk associated with the reconciliation amounts diminishes further. In summary, there is no way in which ComEd's overall cost of capital could automatically reflect the lower risk of regulatory assets resulting from reconciliation amounts, as ComEd claims.

For all the foregoing reasons, including those reasons set forth on pp. 104-107 of Staff's IB, the Commission should adopt Staff's proposed interest rate for reconciliation amounts, for formula ratemaking proceedings.

**3. Regulatory Asset / Deferred Expense Recommendation**

**4. Other**

**D. Other Proposals and Positions Regarding Formula, Tariff Schedules and Attachments, and Processes**

**IX. OTHER**

**A. Distribution System Loss Study**

ComEd continues to recommend use of a revised distribution loss study, identified as ComEd Ex. 7.1, for determining and allocating losses on its distribution system, because it is updated for 2010 class load data. (ComEd IB, p. 122) Staff and

the DOE explain that the distribution system loss study that ComEd identified as Study Report #7B (also ComEd Ex. 27.1) is superior to the distribution loss study that ComEd recommends because Study Report #7B contains updates for both transmission losses and class loads, whereas ComEd Ex. 7.1 contains updates for only class loads.<sup>11</sup> (Staff IB, p. 108; DOE IB p. 2) As an alternative to using the distribution loss study that ComEd identifies as Study Report #7B, both Staff and DOE recommend that the Commission continue using the distribution loss study that it approved in Docket No. 10-0467. (Staff IB, p. 108; DOE IB p. 2)

CG opines that use of either ComEd Ex. 7.1 or ComEd Study Report #7B would, contrary to the statute, change class cost allocations, and therefore the Commission should adopt neither of these updated distribution loss studies. In addition, neither ComEd Ex. 7.1 nor ComEd Study Report #7B includes separation of SEC (secondary) and SERVICE elements, as the Commission specified in its Final Order in Docket No. 10-0467. CG recommends that the Commission continue using the distribution loss study approved in Docket No. 10-0467, or in the alternative, use a different distribution loss study that ComEd identified as Study Report #3. Study Report #3 is the only distribution loss study that separates SEC and SERVICE elements, as the Commission directed in its Final Order in Docket No. 10-0467. (CG IB, pp. 4-8) Staff agrees with CG that neither ComEd Ex. 7.1 nor ComEd Study Report #7B segregate SEC and SERVICE elements and stated that if the Commission rejects use of Study Report #7B because it does not include segregation SEC and SERVICE elements, the Commission

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<sup>11</sup> In its IB, on page 121, ComEd states in error that ComEd filed its updated transmission system loss study pursuant to the ComEd 2010 Order (Order, Docket No. 10-0467, May 24, 2011) in December 2010. ComEd actually filed its updated transmission loss study, identified as ComEd Study Report #7A, on December 21, 2011.

should continue to use the distribution loss factors approved in Docket No. 10-0467. (Staff Ex. 11.0, pp. 3-4 and p. 8) Staff acknowledges that Study Report #3 separates SEC and SERVICES elements, but Staff is strongly opposed to the Commission's use of Study Report #3 because the results of that distribution loss study are clearly erroneous. (Staff Ex. 22.0, p. 5)

Staff continues to recommend that the Commission use the distribution loss study that ComEd identifies as Study Report #7B (and as ComEd Ex. 27.1) because that distribution loss study most accurately reflects actual losses on ComEd's distribution system. In the alternative, the Commission should continue using the distribution loss study it approved in Docket No. 10-0467. (Staff IB, p. 108)

#### **B. Study Report #5**

CTA/Metra request that the Commission's Final Order in this docket grant ComEd a six month extension for filing a report to analyze ways ComEd could eliminate its use of, and/or dependence on, Railroad Class facilities to supply other customers. The Final Order in Docket No. 10-0467 required ComEd to file this report within one year, and the Commission issued the final order on May 24, 2011. (CTA/Metra Joint IB, pp. 7-8) Though not necessarily opposed to a six month extension for filing the report, Staff believes that any request for an extension of the deadline for the report about ComEd's use of railroad facilities should come from ComEd, since ComEd is the sole entity responsible for filing the report. ("These suggestions are reasonable and they are adopted. Therefore, within one year from the date that a Final Order issues in this docket, ComEd shall file a report, ...") (Order, Docket No. 10-0467, May 24, 2011, p. 274)

**X. CONCLUSION**

WHEREFORE, for all of the following reasons, Staff respectfully requests that the Commission's order in this proceeding reflect all of Staff's recommendations regarding the Company's tariffs and charges submitted pursuant to Section 16-108.5 of the Public Utilities Act.

Respectfully submitted,

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